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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking to Establish Guidelines for the Administration of Power Purchase Contracts Between Electric Utilities and Qualifying Facilities.	R.88-06-007 (Filed June 8, 1988)

ORIGINAL

I N D E X

O P I N I O N

I. Summary

This order issues a final set of guidelines for the administration by California electric utilities of standard offer contracts with Qualifying Facilities (QFs). As described in the Order Instituting Rulemaking (OIR), dated June 8, 1988, these guidelines are intended to substitute wherever possible for the case-by-case, prospective consideration by the Commission of these contract modifications.

The contract administration guidelines adopted in this rulemaking are presented in Appendix A.

II. Background

On June 8, 1988, the Commission issued an OIR requesting written comments on a proposed set of contract administration guidelines. The proposed guidelines applied to the contract administration of "standard offer" agreements entered into between California electric utilities and QFs.[1] They were based on the discussion of contract administration in Chapter 4 of the Report to the Legislature on Joint CEC/CPUC Hearings on Excess Electrical Generating Capacity (Joint CEC/CPUC Report) adopted by the Commission on April 27, 1988, pursuant to Senate Bill 1970.

The OIR allowed for a 30-day comment period. In response to a letter filed by Independent Energy Producers (IEP), the

1 "Standard offers" refer to the power purchase agreements that contain standardized prices, terms, and conditions. They are available to all projects meeting the requirements of the standard contract.

Administrative Law Judge (ALJ) extended the filing date until July 15, 1988.

Comments were received by the California Energy Commission (CEC), California Energy Company Inc. (CalCECI), Cogenerators of Southern California (CSC), Sierra Pacific Power Company (SPP), Energy Growth Group (Energy Growth), Arthur Shelton (Shelton), IEP, Bonneville Pacific Corporation (BPC), Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Edison Company (SCE), Independent Power Corporation (IPC), the Public Solar Power Commission (PSPC), and the Division of Ratepayer Advocates (DRA) of the Commission.

The comments of BPC, IPC, and PSPC were late-filed. As discussed below, the motions of BPC and IPC to accept their late-filed comments are granted.

III. Late-Filed Comments and Motions

BPC, IPC, and PSPC failed to file their comments by July 15, 1988, as ordered in the ALJ's ruling dated July 1, 1988.

BPC filed its comments before close of business on July 15, but inadvertently omitted the Certificate of Service with the original and 12 copies. The filing was rejected as incomplete. IPC arrived at the Commission only a few minutes past closing on July 15, 1988. IPC and BPC made sincere efforts to file their comments on time, by sending a representative to file the documents, in person, by close of business, on July 15, 1988. Each party filed a motion, with accompanying declarations, for acceptance of their late-filed comments. Based on the foregoing, we accept IPC and BPC's comments as late-filed documents in this proceeding.

The circumstances surrounding PSPC's filing are significantly different. Several days before the filing date, the ALJ returned a call from a representative of PSPC to confirm that the comments had to be filed no later than July 15, 1988. PSPC apparently mailed its comments on July 15. They did not arrive in the Docket Office until July 19, 1988. PSPC was clearly aware of the requirements and chose not to take the extra effort to try to meet the deadline. Nor did PSPC file a motion for acceptance of the late-filed comments. Based on these circumstances, the comments of PSPC were properly rejected and are not considered in this proceeding.

Finally, CalCECI filed a motion to accept nonsubstantive corrections to its comments filed on July 15, 1988. CalCECI's motion is granted.

IV. Summary of Comments

In general, the commenters support adoption of standardized guidelines on contract administration, but find the proposed language unacceptable without modifications. IEP appears to be the lone voice questioning the need for guidelines at this time. IEP urges the Commission to maintain the option of not issuing them. Others urge the Commission to hold evidentiary hearings on some or all aspects of the rulemaking before finalizing the guidelines (e.g., CalCECI and PG&E).

Specific comments by guideline and issue are summarized below. This summary highlights the range of debate and proposed modifications. It is not intended to be a comprehensive description of all points raised by commenters.

A. General Contract Modifications (Guideline Section I)

Guideline Section I (see Appendix A) requires all negotiated modifications to be accompanied by "price or performance" concessions commensurate in value with the change in the contract. The guideline states that the reference for "commensurate value" is "the unamended contract as well as the current and expected value of the QF's power."

1. How Should Contract Modifications Be Valued?

The comments reflect considerable disagreement over what the standard of reference for "commensurate value" should be. Some commenters argue that the unamended contract should be the sole standard of comparison (SCE, PG&E, IEP). SCE argues that, for a QF that would have come on-line anyway (i.e., that is "viable") this approach is consistent with the standard of "ratepayer indifference." Others support the proposed language, including the reference to current and expected value (e.g., DRA, CEC). DRA argues that there are instances (such as deferrals) where the value is not evident without considering these other factors.

2. How Specific Should the Guidelines Be On What the Commission Will Find Reasonable?

Several commenters urge the Commission to adopt specific criteria for the acceptable methodology and sources of assumptions to use in calculating the value of contract modifications (e.g., IPC, PG&E). In particular, PG&E urges the Commission to augment the proposed guidelines with specific ECAC review standards.

For example, IPC proposes that CEC demand forecasts, coupled with OIR 2 resource plan and fuel price assumptions be used. PG&E recommends that the marginal energy and capacity costs be based on its 1987 filed testimony in OIR 2 until the completion of the upcoming OIR 2 biennial update. PG&E recommends adding language that finds the renegotiation reasonable if the "net present value (NPV) of the estimated overpayments under that contract is less than the estimated overpayments under the unamended contract."

3. Should All Contract Modifications Require Concessions?

IPC proposes that the Commission develop more specific guidelines to distinguish between major ("significant") and minor ("insignificant") contract modifications. In IPC's view, the latter type of change should not require concessions or other changes to the contract. Otherwise, IPC argues, "a change without consequence would become a vehicle by which to virtually extort a change of consequence."

Energy Growth requests that the guidelines clearly distinguish between matters of contract modifications (which would require concessions on the part of the QF) from those of contract interpretation. Energy Growth argues that for issues of contract interpretation (e.g., execution date, change of site within the same parcel of land) a utility should not demand rate concessions equivalent to those that would be required as a condition for obtaining a contract modification.

B. Viability (Guideline Section IV)

In the proposed guidelines, the language requires that, as a prerequisite, a QF must be "viable" under its original standard offer before any contract modifications can be made. Paragraphs 3(a)-(j) provide a list of project status items that the utility should examine in determining viability. If disputes arise over the issue of viability, the guidelines provide for "negotiated modifications" as a reasonable settlement of the dispute. Alternatively, the QF may bring a complaint before the Commission.

Most commenters generally supported the objective of this guideline, namely, to prohibit "breathing life" into moribund projects via contract modifications. However, the comments revealed significant differences of opinion regarding (1) the appropriate criteria for determining viability, (2) the extent to which disputes around this issue should be settled via negotiation, and (3) who should determine viability or bear the burden of proof.

1. **What Criteria Should Be Used to Determine Viability?**

Several commenters support the proposed criteria for determining project viability without any changes (e.g., DRA, SCE, SPP, CEC, SDG&E). PG&E recommends adding an "economic viability" aspect to the list of criteria, which would require submission of a positive cash flow analysis.

Others object strongly to including more than compliance with the Qualifying Facility Milestone Procedure (QFMP) and appropriate status reports (Energy Growth, IEP,).[2] IPC argues that the sole test of viability (and whether or not modifications can be entertained) should be whether or not a QF has "diligently pursued development of the project."

IEP is concerned that the "checklist" of viability items, as presently proposed, will be misused or misinterpreted to suggest that each item is separate from and independent of the other. Energy Growth objects to the requirements that fuel contracts be executed and financing commitments be made by a certain date. Energy Growth argues that the timing of such matters is best left to the QF's own business judgment and may not coincide with the timing of the viability review process. CalCECI argues that the viability criteria would require the QF to disclose information that would place it at a competitive disadvantage in negotiations with the utility.

2. Should Disputes Over Viability Be Resolved Via Negotiated Modifications?

PG&E and IEP support the encouragement of negotiations over the issue of viability. They interpret paragraph 2 of the viability guideline as authorizing such settlements.

DRA and SCE, on the other hand, find the proposed language unacceptable in its present form. DRA believes that the proposed language suggests that merely contesting a utility's

2 The QFMP is a procedure to establish interconnection priority among QFs. This procedure was originally adopted in Decision (D.) 85-01-038 (and modified in subsequent decisions in I.84-04-077, the investigation into transmission constraints impacting QF development).

determination of its nonviability would enable a QF to negotiate modifications to the contract as a "reasonable settlement of the dispute." DRA proposes language changes to clarify that the utility should agree to modifications as a settlement only if the utility is satisfied that there is a genuine question of the QF's viability.

Similarly, SCE is concerned that the proposed language, as written, would force the utility to negotiate contract modifications, even if the utility is convinced of nonviability, and risk disallowance in ECAC. SCE recommends that the entire second sentence (including reference to the complaint process) be deleted.

3. Who Should Determine Viability And Bear the Burden of Proof?

CSC and CalCECI object to placing the utilities in the role of determining viability. CSC argues that the proposed guidelines effectively force the QF to resort to the Commission's complaint or other enforcement procedures, thereby creating unequal negotiating power between the QF and utility.

CSC and others argue that, if a guideline must be adopted, then it should establish a rebuttalable presumption that a QF is viable unless demonstrated otherwise by the utility.

SCE, on the other hand, believes that the burden should be on the QF to establish viability under the terms of the unamended contract. SCE argues that this "burden of proof" provides insurance that the QF will cooperate and provide information adequate for the utility to determine viability.

PG&E recommends revising paragraph 1 to include reference to the QF's duty to deal in good faith. In addition, PG&E would add language to make any negotiated amendment null and void should the QF misrepresent or fail to disclose a material fact concerning the project status.

C. Contract Brokering/New Projects (Guideline Section II)

The proposed guidelines attempt to discourage forms of contract brokering which take on a speculative nature by prohibiting contract modifications in two instances: (1) where the project would not be viable under the original terms of the contract (see Section B above); and (2) where the requested modifications would result in an "essentially new project."

Most of the commenters agree that, in principle, QF contracts should be project-specific, and contract modifications driven by brokering should be limited. However, there is substantial disagreement about how these brokering situations should be defined and identified.

1. Should Contract Modifications Be Rejected for New Projects?

CEC, DRA, SCE, SPP, and others support the proposed approach which automatically rejects consideration of contract modifications for "essentially a new project."

CSC, on the other hand, argues that an "automatic rejection" approach is contrary to the objective of supporting negotiations that result in "win win" situations. Similarly, IPC supports negotiated modifications for a wide range of "significant" changes, as long as concessions are made by the QF.

2. How Should a "New" Project Be Defined?

Several commenters criticize the proposed language for determining what is "essentially a new project" as "vague and ambiguous" (IEP, IPC, CSC). IEP argues that the parties to the contract should be left to determine what is a legitimate assignment and what constitutes an entirely new project. Rather than issue guidelines that are vague and potentially counterproductive, IEP recommends that the Commission implement a "hands off" policy and intervene in specific cases where disputes develop.

SCE supports inclusion of a guideline to define "essentially new" projects, but recommends two language changes. First, SCE recommends that a change in the cogenerator's thermal host be included in the list of modifications that suggest a project is "essentially new."[3] Second, SCE recommends deleting Section II.3(b) of the proposed guideline. SCE argues that, in its experience, multiple amendments usually occur when projects are assigned or provisions such as construction start dates are revised. New projects, on the other hand, are expected to result from a single significant amendment to the contract.

3. Should Language Be Added to Further Limit Assignments?

PG&E proposes specific guidelines to limit assignments. According to PG&E, the assignment dilemma arises from a situation where an apparently moribund QF is purchased by a monied developer. In some instances, the new developer requests significant contract modifications, but also provides convincing evidence that it could build the project under the terms of the existing contract. In other instances, PG&E states that the new developer will attempt to revive the project through force majeure claims.

First, PG&E would add language that finds "unreasonable" certain types of assignments which follow significant contract renegotiations. Second, PG&E would add language that finds a QF's force majeure claim presumptively invalid if the project has a history of repeated assignments. Finally, PG&E would add language that finds a QF "nonviable" if that QF is or has been in bankruptcy. According to PG&E, this language would not impair the

3 A "thermal host" for a cogeneration project is the business entity requiring steam for operations.

contract provision that a utility's consent to an assignment "shall not be unreasonably withheld."

DRA argues that the assignee has as much right to negotiated modifications to a contract as any other developer of a viable project. What is important is the status of the project, and its viability, at the time the modifications are requested (which may be much later in time than the date of assignment). DRA argues that further restrictions on assignments are inappropriate.

D. Five-Year On-Line Date Requirement (Guideline Section IV)

Guideline IV states that the five-year on-line requirement of Standard Offer #4 must be enforced. It provides for exceptions, "where appropriate" because of force majeure conditions. The guideline also identifies, in very broad terms, events that may be considered force majeure (permit delays such as CEC siting and CEC contract deferral conditions).

Guideline IV also provides for negotiation of deferrals/contract buyouts in certain circumstances. First, the ability of the project to meet the original on-line date must be "conclusively demonstrated." Second, ratepayers' interests must be served "demonstrably better" by such deferral or buyout. Finally, the guideline provides broad language on what should be evaluated in determining the reasonableness of deferrals and/or buyouts.

1. Should Force Majeure Extend the Five-Year On-Line Requirement?

Most commenters agree that events constituting force majeure should, in principle, extend the five-year on-line date requirement. However, PG&E argues that "the interrelationship between force majeure and the five-year deadline is too important to be decided on anything other than a complete record." Consistent with its position during the Joint CPUC/CEC Hearings on Excess Electrical Generating Capacity, PG&E takes the position that force majeure should not excuse the QF from its on-line date.[4] PG&E urges the Commission to delete (or significantly revise) paragraphs 3 and 4 of the guideline on force majeure issues.

SCE and DRA recommend language that "condition" the extent to which force majeure can delay the on-line requirement. SCE recommends that any extension be limited to the duration of the force majeure, and the extent to which the QF can demonstrate that the force majeure affected its ability to meet contract requirements. SCE would also add the requirement that the QF be in compliance with the QFMP, in addition to the contract, before any extensions be considered. DRA would add language to exclude consideration of time extensions where the project would not be viable in the absence of the force majeure.

2. Should Disputes Over Force Majeure be "Negotiable"?

The proposed guidelines do not explicitly provide for "negotiation" as a reasonable settlement of disputes over force majeure (as they do for disputes over viability). PG&E and BPC urge the Commission to allow broader utility discretion in negotiating with developers who would otherwise seek remedies under the force majeure provisions. PG&E states that QFs are submitting force majeure claims to PG&E at an increasing rate. According to PG&E, it attempts to negotiate settlements of these claims, just as it attempts to resolve all other legitimate contract disputes. In its comments, PG&E lists a litany of current disputes surrounding the force majeure issue, and discusses its interpretation of those issues. PG&E recommends that language be added to the guidelines authorizing the negotiation of deferrals where the QF has

4 See Section VI of PG&E's Supplemental Comments, dated September 23, 1987, in the CPUC/CEC Joint Hearings on Excess Electrical Generating Capacity.

experienced a force majeure condition. PG&E and BPC argue that the ratepayers are worse off without such negotiations, since the result could be a deferral without commensurate economic concessions.

3. Should the Guidelines Interpret Force Majeure?

There is considerable difference of opinion on whether the CPUC should interpret force majeure in these guidelines, and, if so, what that interpretation should be.

BPC, IPC, and others recommend that the guidelines clearly delineate situations that constitute a force majeure condition. For example, BPC submits three such situations: the unexpected exercise of CEC jurisdiction over a project, permitting delays resulting from state or local agencies' failure to act, and permit-related litigation. Energy Growth would include all unforeseeable permitting delays associated with regulatory approvals by federal, state, or local agencies.

SCE argues, on the other hand, that the intent of the force majeure clause was to cover unanticipated changes, not "common events" such as permitting delays and/or preliminary denials. In particular, SCE objects to the example of delays in "CEC siting permits" as valid claims of force majeure.

DRA also objects to the inclusion of specific language regarding force majeure interpretation. In particular, DRA argues that the language on CEC contract deferral conditions is misleading because it suggests that unforeseeability is a decisive test in determining whether a force majeure claim is valid. DRA would delete this sentence entirely.

CEC, on the other hand, supports the interpretive language in the proposed guidelines, arguing that it is consistent with the SB 1970 Report discussion and carefully reflects applicable law. CEC recommends that this language be adopted without change.

Finally, both PG&E and IEP recommend that all interpretive language be deleted. PG&E recommends further evidentiary hearings before developing guidelines on this issue. Again, IEP questions whether there is a need for guidelines at this time.

4. <u>When Should the Five-Year On-Line Requirement Begin</u>?

The proposed guidelines currently state that the five-year on-line requirement begins when "both the QF and the utility have signed the contract" (Section III.1).

PG&E objects to this interpretation, while others (Energy Growth, IPC) agree with the language. PG&E argues that this rulemaking proceeding should not resolve this or other substantive issues of contract interpretation. PG&E believes that the Commission clarified its intent in prior Commission decisions to start the five-year deadline from the QF's execution date.

Further, PG&E states that it has been negotiating compromises giving QFs five years from the last execution date in exchange for concessions. PG&E proposes to add language that authorizes utilities and QFs to negotiate disputes over when the five-year period begins. In addition, PG&E proposes language to find reasonable its current practices of freezing fixed capacity and energy prices in exchange for the later execution date.

5. Is the "Conclusively Demonstrate" Standard <u>Appropriate for Deferrals And Buyouts?</u>

IEP, BPC, PG&E, and others object to the standard that projects "conclusively demonstrate" their ability to meet the original on-line date before deferrals/buyouts can be negotiated. IEP argues that the ability to come on-line cannot be "conclusively" determined until it actually happens. PG&E states that the language will effectively put a halt to all negotiations on deferrals or buyouts.

Other standards of proof were proposed. IEP recommends the use of an "evidentiary standard" (more probable than not). CSC recommends that proof of a critical path schedule, showing the permitting and construction milestones necessary to meet the on-line date, be sufficient. IPC recommends the "diligent pursuit of a project" as the appropriate prerequisite. PG&E argues that the standard of proof should be the same for all contract modifications whether deferrals/buyouts or not. Specifically, PG&E recommends that deferrals and buyouts be negotiated only with projects which "demonstrate a significant likelihood of meeting the unamended on-line date."

DRA, on the other hand, argues that for paid deferrals and buyouts, the QF's viability must be conclusively demonstrated with regard to any and all contract terms, not just the original on-line date. DRA acknowledges that it is difficult, "if not impossible", to demonstrate beyond a doubt that a QF could actually come on-line under the terms of the original contract. However, because of the added risk of paid deferrals and buyouts, DRA argues that they should only be negotiated with projects who have already obtained any necessary permits and certifications, and have passed muster under the other viability standards outlined in Guideline Section IV.

6. Should Buyouts And Deferrals Be Treated Equally?

CEC objects to the apparent "equal treatment" being given to buyouts. CEC argues that the SB 1970 Report makes clear that proposals for buyouts will not be looked on with favor. As discussed in the SB 1970 Report, the principle reason for this differing treatment is that deferrals require a forecast for only a limited number of years, whereas buyouts require a forecast (with attendant uncertainties) for the life of the bought-out contract. Accordingly, CEC recommends that paragraphs 5-7 be revised to reflect the less favored status of buyouts.

DRA is also concerned about the treatment both of buyouts and of paid deferrals. DRA argues that the risks to ratepayers of paid deferrals are much greater than nonpaid deferrals. DRA recommends that the Commission carefully scrutinize the reasonableness of paid deferrals and buyouts on a case-by-case basis.

V. Discussion

The comments presented reflect a wide range of opinion regarding the philosophy, as well as the specifics, of the proposed guidelines. Commenters present several different perspectives on the spectrum of negotiations contemplated, as well as the criteria for reasonableness of those negotiations. Clarification of our policies, in the form of guidelines, is needed to ensure that productive resolutions between parties may more easily be reached.

Our overriding principle in contract negotiations is, as described in Chapter 4 of the Joint CEC/CPUC Report, that "a deal is a deal." Any QF able to meet the terms and conditions of its standard offer is entitled to the payments contained in that contract. We continue to reject any suggestion that contract modifications or abrogation should be unilaterally imposed on QFs that are under contract.

This principle applies equally to the QF's end of the bargain. Standard offers were developed as "package deals"--the price and performance requirements were considered, as a whole, to be reasonable to ratepayers, and automatic approval of those terms by the Commission was guaranteed. This is particularly relevant for interim Standard Offer #4 which was developed via a negotiating conference procedure, and presented to the Commission as a negotiated package. QFs do not have an automatic right to modify a standard offer--nor do utilities have an obligation to agree to any and all requested changes. A utility should agree to modify only if commensurate concessions are made to benefit ratepayers.

Within this framework, our guidelines anticipate and minimize any potential negative impacts of contract modifications on the resource planning process. Standard offers designed to provide longer-term price certainty to QFs are based on projections of the resource needs of utilities at the time they are developed.[5] Inevitably, those projections will involve some degree of error. Consistent with our principle of "a deal is a deal," we will not penalize the QF who can actually come on line under standard offer terms that might not, given today's realities, be offered to future QFs.

However, we draw the line where a QF's viability is in question. Nonviable QFs that signed up under standard offers reflecting relatively high projections of energy and capacity needs should not be able to "hold on to" or "broker" their contracts as updates to the standard offers yield less favorable terms. We agree with DRA that, from a resource planning perspective, the ratepayer would prefer terminating the failed project. The utility would then pursue negotiations with another resource (including QFs) at prices and terms that reflect the current resource planning realities. Further, the importance of viability is consistent with our intention in the QF program that ratepayers be generally insulated from development risks.

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5 Standard Offer #2 and Interim Standard Offer #4 are called "long run" offers because they offer fixed prices (for energy, capacity, or both) for a period of 10 to 30 years, while the "short run" standard offers (#1 and #3) pay only variable prices based on the current values of energy and capacity. While Interim Standard Offer #4 was developed in a negotiating conference, rather than our current OIR 2 evidentiary process, implicit in those negotiations were the participants' expectations concerning future trends of energy prices and resource needs.

Hence, implicit in the assignment of ratepayer benefits to any contract modification is the assumption that a QF is viable under the terms of the unamended contract. We recognize, as do many of the commenters, that posing the question, "Is the QF viable?" is far easier than answering it with complete confidence. However, we do not agree with suggested language changes that, effectively, remove viability as a primary consideration in assessing the benefits and risks of renegotiations. We expect project viability to be considered before negotiations are pursued.

A. Viability

Several commenters argue that the criteria for determining viability should be limited to compliance with the QFMP and the appropriate status reports. However, the QF can be in various stages of project development and still be in compliance with that procedure. For example, under the QFMP, a QF is required to file its critical path permit within 18 months of submitting a project definition.[6] The next "binding" milestone for maintaining interconnection priority is start of construction. Events occuring between the filing of a critical path permit and start of construction may significantly reduce the likelihood that the project can come on line.

Furthermore, a project that misses a milestone can be in compliance with the QFMP by reestablishing new interconnection priority via the notice and cure provisions. These provisions require that a QF file a new project definition, a request for interconnection study, and an updated project development schedule. We do not agree that this information is sufficient for assessing

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6 In the QFMP, a "project definition" requires information on proof of site control, capacity and annual output, location and description of the site, project ownership, fuel source, etc. See D.87-04-039 for the most recent version of the QFMP requirements.

the likelihood that a project will meet the original terms of its standard contract.

The QFMP procedure was developed to establish interconnection priorities in transmission-constrained areas, and to improve overall communication of project status between the QF and the utility. For that purpose, the compliance requirements promote continuing communication of a QF's intent to proceed. For QFs proceeding under the original terms of their standard offer, this approach is an effective one. However, we reject the notion that compliance with the QFMP, or the standard of "diligent pursuit" of a project is a sufficient prerequisite for any and all modifications of a standard offer.

IEP raises the concern that the "checklist" of viability criteria in Section IV. 3 of the proposed guidelines will be misused or misinterpreted. IEP describes situations where a modification may be needed due to transmission constraints (e.g., partial allocation of transmission requiring down-sizing) or permitting requirements (e.g., permits contingent upon change of fuel or size, or both). Under both types of circumstances, a "diligent" QF (i.e., one that is in compliance with the QFMP and actively pursuing project development) may need a contract modification to ensure continued viability. The status of some of the items listed under IV. 3 may be contingent upon approval of that change.

We agree with IEP that each QF need not have every aspect of the project's fuel supply, construction, financing, and permits finalized before a utility can consider a requested modification. The utility needs to consider these and other aspects as a whole and the reasons behind the current status of individual items in light of the requested modifications. As IEP points out, there may be certain circumstances where the determination of a QF's viability is more subtle, and cannot be evaluated with a "checklist" approach. For this reason, we will add language to clarify that the items presented under Section IV. 3. are not to be interpreted to suggest that each item is separate from and independent of the others. However, as discussed above, we retain items from that list that are not contained in the QFMP.

We also add IEP's suggestion that utilities consider the QF's prior track record on project development, and PG&E's suggestion that the QF submit a cash flow analysis. In all cases, however, we emphasize that the status of each item be considered to develop a total picture of a QF's viability; an item should not be administered as an "all or nothing" screening device.

Several commenters also suggested changes or requested clarification of our intent regarding the resolution of disputes over viability. We do not force the utility to negotiate contract modifications if the utility is convinced of nonviability. Instead, we provide a forum for settlement only if the utility is satisfied that there is a genuine question of a QF's viability. We will add language clarifying that intent.

We do not believe that the proposed guidelines, in and of themselves, create a bargaining climate that differs from the current environment in which QFs enter into contracts, and negotiate contract modifications. As in the past, the QF can enter into a standard offer agreement at its sole option, without negotiating terms and conditions with the utility. Where a QF chooses to negotiate a nonstandard offer, or modify a standard offer, the utility is required to respond to proposals and negotiate in good faith. This has not changed. We reiterate our expectations that utilities deal in good faith with the QF in all contract negotiations (see Guideline IV).

Several commenters have requested that we impose explicit time restrictions on negotiations, or otherwise make allowances for the time involved in the negotiation process. For example, Energy Growth recommends that both utilities and QFs be required to respond to each other's inquiries within 10 working days. Energy

Growth further recommends that QFs be granted day-for-day extensions of the five-year on-line requirement to account for the viability review period. IEP recommends that a utility's consent to assignments be required within ten to 30 days of the request, depending on the nature of the assignment request.

We have been approached in the past with proposals for formal schedules regarding negotiations. As a general policy, we are not inclined to require such procedures. The give and take of contract negotiations are not readily reduced to formal schedules, and enforcement of those schedules requires parties to conduct their affairs in an overly rigid fashion.[7]

However, we recognize that utilities are in a much better position to control the timing of negotiations over standard offers, and that can work to the detriment of QFs which are subject to strict contract deadlines and construction constraints. This is particularly pertinent over the next 18-month period as the five-year on-line deadline approaches for many QFs. At the very least, a QF needs to know "where it stands" with regard to a utility's position on threshold issues, such as viability, so it can decide how to proceed in the case of a dispute.

Therefore, for a limited period, we agree to place some time requirements on negotiations related to modifications of standard offers. Specifically, we will require the utility's response to a proposal for contract modification of a standard offer to be made within 30 days of the receipt of the QF's initial proposal/inquiry. Consistent with the good faith standards articulated in D.82-01-103, when a utility is unwilling or unable

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7 Our previous consideration and denial of formal time schedules for QF/utility negotiations is discussed in D.82-03-027, page 105 (mimeo.).

to accept a QF's proposal, the utility's response must include either a counteroffer or an explanation of:

1. The specific information needed to evaluate the proposal;
2. The precise difficulty encountered in evaluating the proposal;
3. The estimated date when it will respond to the proposal.

We are unwilling to dictate specific time schedules beyond this 30-day requirement. Throughout the negotiating process, however, utilities are expected and will be required to respond to inquiries on a timely basis, and to provide the information outlined above. As in the past, the Commission will entertain formal complaints raised by QFs who can demonstrate that the utility has failed to bargain in good faith, since a utility found not to have bargained in good faith stands in violation of the Commission's orders.

With regard to the QF's obligations, we do not believe that explicit time restrictions or "burden of proof" additions are necessary. The QF already has a strong incentive to provide information that is adequate and accurate for a utility's review. Delay or uncooperativeness on the QF's part only results in a protracted review/negotiation process, which works to the QF's disadvantage.

B. <u>General Contract Modifications</u>

Several commenters urge us to expand the language of Guideline I to include specific criteria for judging reasonableness at a future date, including sources of input assumptions. We disagree. The guidelines we are issuing today are, as in the past, advisory: they communicate general policies and principles to be followed for contract modifications.[8]

We expect utilities to evaluate proposed modifications taking into account the most recently adopted OIR 2 resource planning assumptions. However, we do not expect them to ignore significant changes to the resource plan or updated projections that have been developed in the interim. Also, we do not dictate a single methodology for evaluating reasonableness. Including these specifics in guidelines would undermine their primary function, namely, to provide policy guidance over a wide range of specific circumstances.

In addition, providing explicit "how to" instructions in guidelines wrongly implies that we will relieve the utility of their burden of proof in reasonableness reviews. Utilities are held to a standard of reasonableness based upon the facts that are known or should be known at the time the utility makes a decision. While this reasonableness standard can be clarified through the adoption of guidelines, guidelines do not relieve the utility of its burden of proof.

We reject proposals that would eliminate reference to anything other than the unamended contract as the standard for "commensurate value." We agree with DRA that the value of some contract modifications, like deferrals, is not evident without considering other factors. Further, the value of certain concessions (such as dispatchability, voltage support, and emergency availability) should be valued using current expectations of the utility's system and economic conditions. However, we will modify the guidelines to allow for those circumstances where the

8 See, for example, D.87-07-026, page 19-20 (mimeo.) for a discussion of the function of guidelines. These principles were reiterated in D.88-03-036, page 5 (mimeo.).

unamended contract alone is the appropriate point of reference. We will also provide examples of performance features, as suggested by SCE, when the term is first used in the guidelines.

With regard to the concerns raised by IEP, IPC, and Energy Growth, we do not believe that the guidelines can be interpreted to give utilities license to alter standard offers into short-run spot market contracts, or in other ways "extort a change of consequence" from minor requests. In D.87-07-086, we made our position clear that the concessions required by utilities cannot be disproportionate to the modifications requested by the QF.[9] Similarly, in the Joint CEC/CPUC Report, we stated:

> "Thus, a single minor change (e.g., a project relocation within the same parcel of land) could reasonably be allowed by the utility in exchange for minimal price concessions or performance features. A more significant change may substantially affect the costs and value of the QF's power to the utility system and should be accompanied by correspondingly greater price and performance term benefits for ratepayers.
>
> "This principle applies to other modifications as well. A QF seeking to change its fuel source from biomass to oil or gas, for example, would reduce ratepayer benefits more than a change from gas to oil. Utilities should obtain greater concessions for the former sort of fuel change than for the latter, due to its effect on the state's fuel diversity goals."[10]

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9 See D.87-07-086, Basic American Foods vs. PG&E, page 5 (mimeo.).

10 Joint CEC/CPUC Report, pages 93-94. In the example of a project relocation within the same parcel of land, the report states "the QF would certainly have to pay for a new interconnection study or other direct costs that the modification may cause" (footnote 8).

These principles are reflected in Guideline I, which explicitly requires that concessions be commensurate in value "with the degree of the change in the contract." We do not find merit in IPC's proposal to further delineate "major" and "minor" changes.

Energy Growth asks us to distinguish between contract interpretation issues and contract modifications. We cannot. The difference is often in the eye of the beholder. In the case of an interpretation issue, the QF believes that its actions (e.g., site changes) are within its rights under the existing contract and does not request contract modifications. In the case of a contract modification, the QF does not believe that its actions are permissible under the contract, and therefore requests language modifications. It is absurd to suggest that whenever the QF characterizes an issue as "interpretation," the utility should refrain from requiring concessions in a negotiated settlement.

When interpretation disputes arise, these guidelines provide an appropriate framework for negotiating settlements. However, they do not give utilities the license to "create" interpretation disputes as a means for extracting concessions. The utility should neither search out ambiguity or contort its interpretation of contract language in order to force the QF to modify its contract, nor request disproportionate concessions in negotiating a settlement of interpretation disputes. To do so would violate our "good faith" requirement for utilities. If clarification of Commission policy is required, the utility should promptly petition the Commission to resolve the issue.

C. <u>Contract Brokering/New Projects</u>

As discussed above, we hold the QF to its end of "a deal is a deal." Just as the utilities (and ultimately their ratepayers) are obliged to honor their commitments under the standard offer program, in signing a standard offer QF developers assume the risk that they will not be able to perform under the terms of their contracts. This risk would be eliminated, to the detriment of ratepayers, if we allowed developers to transfer a standard offer from one project to another, on a speculative basis.

In its comments, CSC asserts that contract modifications can provide "win win" situations, even if the modifications result in essentially a new project. We are persuaded to the contrary by DRA's arguments:

> "Regardless of the value of the concessions extracted, when the cost of the amended contract is above the utility's avoided costs, the ratepayer is always better off holding a nonviable project to the terms of the original contract than allowing the transfer of the contract to a new project. . . . The developer who wishes to develop a new QF contract may enter into a currently available standard offer, or wait to build his project until demand growth leads to the availability of standard offers whose terms make his project profitable. The developer should not be allowed to short-circuit the process...by transferring a contract from a failed project to a new one."[11]

From a wide range of comments on our guidelines on contract brokering and new projects, we have decided to make only two modifications.

First, we will add that a change in the cogenerator's thermal host may suggest that a project is "essentially new." We agree with SCE that this type of change for a project which has not yet begun construction and is requesting other substantive modifications (see II.3.a) might suggest a significant revision to the project scope.

However, as with all the items listed under Section II.3., the mere presence of such a change does not render it automatically significant enough to refuse negotiations. The

11 Division of Ratepayer Advocates Comments on the Proposed Guidelines, July 15, 1988, pages 3-4.

utility cannot be arbitrary in its decisionmaking. In considering whether or not the proposed modifications represent an "essentially new" project, the utility must be mindful of its duty to deal in good faith with the QF. Our second modification will be to add language to that effect.

We will not adopt PG&E's requested language modifications to further limit assignments. While requests for modifications to an assigned contract may cause the utility to scrutinize project viability closely, we do not believe that further restrictions on assignments are appropriate.

D. Five-Year On-Line Date Requirement

Contrary to the assertions made by PG&E, the issue of which execution date (the QF's or the utility's) begins the five-year on-line requirement has never been addressed by this Commission. PG&E cites D.85-06-163 and D.86-10-038 in support of its position that the five-year requirement begins when the QF signs the agreement. In both cases, PG&E has used the decision language out of context.

In D.85-06-163, the Commission was faced with the specific circumstance where a QF had signed, but the utility had not yet countersigned, an Interim Standard Offer #4 agreement prior to this Commission's suspension of that offer. The sole issue concerning signature dates that was addressed in D.85-06-163 was the date of contract formation, i.e., when had the QF established its entitlement to a contract? In that decision we determined that the contractual obligation to purchase power from the QF, under the terms of a standard offer, would begin once the QF signed the agreement. The issue of the beginning date for the five-year requirement was neither raised nor addressed.

In D.86-10-038, the Commission addressed three petitions for modification of D.83-09-054, which issued Interim Standard Offer #4. The only reference to the five-year on-line date was a minor informational footnote added to clarify why PG&E's fixed price tables might need to be extended past 1987. The issue of calculating the five-year deadline was never discussed in the decision text, findings of fact, or conclusions of law. None of the petitioners and respondents (PG&E included) raised the issue.

This rulemaking is the appropriate proceeding in which to address the execution date issue raised by PG&E and others. The five-year requirement should begin on the earliest date a QF can be reasonably expected to pursue project development. A QF cannot be expected to approach financing institutions, fuel suppliers, or government entities without a fully executed contract. PG&E's Interim Standard Offer #4 language clearly states that the agreement is effective as of the last signature date. To expect a QF to commence development activities prior to the effective date of the agreement would be unreasonable.[12] Accordingly, we will adopt the language in Guideline III.1. as originally proposed.

E. Force Majeure

"Force majeure" is a legal doctrine. It refers to uncontrollable or unforeseeable circumstances or actions which would relieve one party in a contract from certain obligations. The Commission described force majeure in D.83-10-093 as follows:

> "When the occurrence of a force majeure renders a party wholly or partly unable to perform under the contract, the party is excused from that performance to the extent that it has notified the other party of the occurrence, suspended its performance only for the period required by the force majeure, and used its

12 Only PG&E's Interim Standard Offer #4 language (Article 12) provides for two "signature dates," and references both an "effective date" and an "execution date." The contract language in SCE's and SDG&E's standard offers have a single execution date (no individual signature dates on their signature page), with the five-year on-line date commencing upon contract execution. However, our reasoning still applies: the QF cannot be expected to proceed until the utility has signed.

best efforts to remedy its inability to perform."[13]

During the Joint CEC/CPUC Hearings, the issue of force majeure and its applicability to the five-year deadline was addressed by almost every participant, including PG&E. As in this rulemaking proceeding, there were a wide range of opinions. With regard to PG&E's assertion that the force majeure doctrine should not apply under any circumstances to extension of the on-line requirement, we concluded:

> "As a general matter, PG&E's argument cuts far too broadly. While it is true that PG&E's SO 2 and Interim SO 4 both provide that the agreement will terminate in the event the QF fails to come on-line within five years, it cannot be said that QFs proceeding forward under these contracts have no "obligations." To ignore potential conditions or obligations to perform that rise from the on-line date may be inconsistent with the contract terms themselves, and could also lead to forfeiture of a very substantial QF investment. . . . Moreover, we note that in other contexts, force majeure clauses have been applied to prevent such forfeiture."[14]

This is still our view. However, we agree with SCE that any extension granted as a result of force majeure should be limited to the duration of the force majeure, and the extent to which the QF can demonstrate that the force majeure affected its ability to meet contract requirements. Furthermore, consistent with the terms of the standard offer contract, a QF must be prepared to show that it properly notified the utility, and took steps to overcome the effect of the force majeure, using due diligence. Finally, the occurrence of force majeure does not alter

13 D.83-10-093, page 80 (mimeo), and see Conclusion of Law 22.

14 Joint CEC/CPUC Report, pp. 100-101.

contract terms that are not directly affected by the force majeure event.

A force majeure may not always lead to an extension beyond the five-year limit. A project may be delayed as a result of force majeure, but still be able to begin operation prior to the five-year deadline. This is consistent with Commission policy, as set forth in D.83-10-093, and reflected in the standard offers. We add SCE's proposed language to that effect. This language should also dispel DRA's concerns that a nonviable QF could use the force majeure claim to excuse all types of nonperformance.

The purpose of a force majeure clause is to allocate the risk of nonperformance appropriately between the parties to a contract. In a standard offer contract, the risk of nonperformance is properly allocated to the QF, not the utility or its ratepayers. An inherent part of the standard offer "deal" is that the utility and ratepayers can count on the QF resource coming on-line as planned, and they are not at risk for delays or cost overruns in the QF's development. In exchange for a contract at full avoided cost, the QF assumes the risk that the five-year development stage may not be sufficient to develop its project.

In D.83-10-093, we tempered the QF's risk of nonperformance by excusing a QF from the full burden of "unanticipated" or "unforeseeable" actions of legislative, judicial, and regulatory agencies. Our policy statement in that decision was consistent with PG&E's proposed force majeure clause:

> "We believe that a scheme similar to that proposed by PG&E, if expanded to include actions by the courts and legislature, provides reasonable certainty in the face of potential legal changes. It also prevents utilities from being placed in the untenable position of being bound to a contract which violates the law. <u>Unanticipated changes in law are the fault of neither party, and neither party should be held</u>

> in breach of contract as a result of those changes. (Emphasis added.)[15]

Our intent was to excuse the QF from "unanticipated" changes in the law, and to prevent the utilities from being placed in the untenable position of being bound to a contract that violates the law.

We do not change that policy. We agree with CEC, DRA, and SCE, however, that not all government orders and regulatory actions are "unanticipated" or "unforeseeable," thereby qualifying as a force majeure event under the standard offers. In particular, we agree with SCE and DRA that most permitting delays are common events and should be anticipated by project developers when they commit to deliver power to a utility. We add language to that effect.[16]

DRA argues that deferral conditions imposed by CEC are also probably foreseeable, and should not be specifically identified as a valid claim of force majeure in our guidelines. We disagree. In the Joint CEC/CPUC Report, the two Commissions concluded that this type of license condition was not forseeable when the standard offer terms were signed. We continue to support that conclusion. Similarly, we support the conclusion that it was foreseeable that a QF in PG&E's transmission-constrained area might not be able to obtain the necessary transmission capacity.

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15 D.83-10-093, page 81, mimeo.

16 Edison also proposes language requiring the QF to be in compliance with the QFMP, in addition to "all contractual requirements in claiming the protection of the force majeure clause" under Guideline III, paragraph 2. This would only be appropriate if the contract language explicitly required compliance with the QFMP to excuse a QF's performance under force majeure. This is not the case. Further, compliance with some of the specific time requirements of the QFMP (e.g., start of construction) may be rendered impossible by the force majeure event. We reject Edison's proposed requirement.

However, as pointed out by DRA and others, the mere presence of an "unanticipated or unforeseeable" event does not automatically excuse nonperformance under force majeure.

Several commenters in this proceeding urge us to identify additional specific circumstances under which a QF may (or may not) invoke the force majeure clause. We have reviewed the comments carefully and conclude that any further identification of those circumstances, as well as the effect of force majeure on the utilities' obligations, should be considered as cases arise. The complex factual and legal nature of force majeure requires us to take a case-by-case approach.

The QF claiming force majeure must establish that the particular delay, and duration of delay, was unanticipated at the time the contract was entered into. The QF must also show that it was without any fault or negligence in contributing to the delay, and that it has been diligent in attempting to end any delay. The QF must also have given the required notice of the delay.

Assuming that the QF proves that it meets these criteria, the effect of the force majeure must be determined. Before considering a deferral of the on-line date, the extent to which the force majeure event (and not other factors) impacted the QF's ability to meet that requirement must be assessed. If a permit deferral condition is imposed, then the difficult questions of whether, at what price, and for how many years the QF may be entitled to sell power under its contract must be answered. Deliberations over these issues require an examination of all the surrounding circumstances.

PG&E and BPC recommend that language be added to the guidelines authorizing the negotiation of deferrals, with concessions, where the QF would otherwise seek remedies under force majeure. We never intended to preclude negotiated settlements over force majeure in cases where the utility is satisfied that the QF has a legitimate claim and has fulfilled its contractual requirements. However, as discussed above, the force majeure doctrine imposes a heavy burden of proof to excuse nonperformance with regard to the on-line requirement. We expect the utility to carefully scrutinize each claim of force majeure, consistent with these guidelines, and negotiate only in instances where it is convinced that a settlement, versus adjudication, is in the ratepayers' best interest.

Finally, as suggested by SCE, we clarify our intent that contract modifications relating to other aspects of the contract will not extend the on-line date requirement.

F. Deferrals and Buyouts

As pointed out by DRA and CEC in their comments, our proposed guidelines do not distinguish between "nonpaid" deferrals and "paid" deferrals/buyouts. Based on our review of their comments, we conclude that the final guidelines should distinguish clearly between negotiations that would require ratepayers to "pay" for a deferral or buyout, and those that result in nonpaid deferrals.

Concerning the "viability standard" for deferrals or buyouts, we agree with several of the commenters that the language of the proposed guidelines (i.e., "conclusively demonstrate") is an impractical standard. However, we are neither willing to approach deferrals/buyouts with standards that render viability a minor consideration (as implied in some of the comments), nor do we agree with PG&E that the same language with regard to viability should apply to all types of proposed contract modifications.

We still think that a negotiated deferral (paid or nonpaid) or buyout, compared to any other type of contract modification, puts the ratepayer at the greatest risk that the agreement breathes life into a moribund QF. Accordingly, our threshold test of viability for these types of modifications will be stringent.

At what point in the development stage is a deferral/buyout least likely to "save" a troubled project, but at the same time offer some assurances that the project has a reasonable likelihood of meeting the on-line requirement? Once a QF begins construction, the probability is reasonably high that the project will come on line. However, at this point in time the QF is committed, and any deferral or buyout becomes impractical. On the other hand, a deferral or buyout after the QF has applied for its permits or certification (but before they are approved) would be of value to some QFs. At that point, however, uncertainties regarding the QF's ability to meet the on-line date (will it get its permit, will it meet its construction timetable, will it have sufficient cash flow and financing commitment to bring the project into operation) are also significant.

Generally, the QF should have obtained all necessary permits/certifications as a prerequisite for deferral or buyout. Even after permits/certifications are obtained, the ratepayer faces some risk that the project could not have gone forward without the deferral/buyout. But this is balanced with the certainty that the project has passed a major milestone in its development.

Any specific prerequisite will have some drawbacks. Circumstances may exist where consideration should be given to a project that has not yet obtained all of its permits or certifications. However, we find it preferable to articulate an explicit prerequisite for these types of negotiations, rather than include language that renders interpretation impossible.[17]

Utilities may negotiate <u>nonpaid</u> deferrals, when they clearly serve the ratepayers' interest. With regard to <u>paid</u>

17 Some permits, for example, may include expiration dates that are difficult to extend. However, in such cases, the "negotiating room" for a deferral will be necessarily constrained by that condition.

deferrals and buyouts, however, we take a more cautious approach. We consider these types of modifications in the context of our overall approach to resource planning.

The long-run standard offer program reflects a planning approach that uses forecasts to value resource additions (i.e., projections of avoided costs). Once the forecast is made, and the standard offers are made available, the Commission's role is limited to hearing complaints and to reviewing the reasonableness of utility conduct in exercising its rights and duties under the contract.

The program was developed with the basic premise that, over time, the inevitable over- and underpayments would balance each other out. Successive cohorts of QFs with long-term standard offers will reflect varying resource assumptions and create a "portfolio" of power supply contracts. At any given time, some of these contracts may involve payments higher than actual avoided costs, while some are lower. At different times, payments under the <u>same</u> contract may be lower or higher. In a diversified portfolio, these "over" and "under" payments should balance out over time.

We never intended to revisit each forecast of avoided costs in subsequent years (either before or after the on-line date), and adjust payments for individual long-term standard offers to reflect new projections of avoided costs. Our response to changing perceptions of resource needs is to update the terms of long-term offers for new QFs, not to try to modify existing contracts. Paid deferrals and buyouts make sense only if the risks and benefits are unacceptably "skewed" to the long-term detriment of the ratepayer. Based on the record of the Joint CEC/CPUC hearings, we are not convinced that this is the case.

Further, we are concerned about the longer-term implications of a "hybrid" approach--namely, a program that establishes standard offers but also considers paid deferrals and buyouts. We suspect that, during each standard offer "cycle" as the on-line date approaches, an increasing number of QFs signed up under contracts that "overpay" in the early years would propose upfront payment to ensure that they don't come on line. Proposals for buyouts would also increase. We also suspect that QFs signed up under contracts with "underpayments" might propose upfront payments to induce them to come on line earlier than the contract on-line date.

If our suspicions are correct, all the issues and uncertainties facing us in contract administration will be magnified, and the long-run standard offer portfolio policy subverted. Furthermore, in the case of paid deferrals, the ratepayer would be put in the position of financing these projects in a "front-loaded" fashion (i.e., high upfront payments, with lower negotiated fixed payments later on). This represents a marked departure from past policies on how to structure avoided cost payments to QFs.

Aside from overall policy concerns, we are further convinced by the arguments presented by DRA and CEC that the implementation problems associated with paid deferrals and buyouts dictate a cautious approach. In both cases, ratepayers not only run the risk that the agreement breaths life into a moribund QF, but also that they are paying money for something they would have received for free, if the project were in fact not viable. Even when project viability is not in dispute, there is tremendous uncertainty over the ratepayer benefits of a paid deferral or buyout.

For these reasons, we will scrutinize the reasonableness of paid deferrals and buyouts on a case-by-case basis. If a utility believes, either now or in the future, that a buyout or paid deferral can be justified given our reservations, it must apply to this Commission for preapproval. Any application for preapproval of paid deferrals or buyouts must include documentation demonstrating that the utility has examined information on project viability, consistent with these guidelines, and that the utility is satisfied that the QF is able to meet the original terms of the contract.

G. Other Issues

1. QFMP and Interconnection

Shelton urges the Commission to prohibit negotiated deferrals in PG&E's transmission constrained areas until the priority lists in the constrained areas are "purged" of QFs who cannot provide reasonable assurance of their continued viability under their existing contracts. He argues that the proposed guidelines could adversely affect transmission allocation to a viable project brought forward on schedule in reasonable good-faith reliance upon the existing rules.

We agree with Shelton in principle, but not with his specific proposals. As already discussed, the utility must be satisfied that a project is viable before negotiating any on-line date deferrals. The viability prerequisite for deferrals/buyouts is intentionally more stringent than for other types of modifications. The proposed guidelines, as modified, should address the primary concern of Shelton, namely, that negotiations will breath life into failed projects that are precluding viable ones from access to limited transmission.

We do not direct any utility to unilaterally "purge" the interconnection waiting list based on an assessment of viability under these guidelines. A QF is entitled to maintain its interconnection priority as long as it complies with the requirements of the QFMP.

If Shelton believes that PG&E is improperly administering that procedure, he should bring it to our attention through the complaint process. Administrative stalling could be considered an act of bad faith on the part of the utility which could justify an extension of the five-year deadline. However, we have not heard of a single project that stayed on the priority list after either missing a milestone or telling PG&E it would not go on-line.

Similarly, the interconnection issues raised by CalCECI on the QFMP should be brought to our attention either through a petition to modify D.87-04-039, or via the complaint process.[18]

PG&E requests confirmation that deferrals of the five-year on-line date would correspondingly extend the QFMP "start of operation" milestone. This would enable a QF to retain its interconnection priority. Otherwise, PG&E argues, few would agree to deferrals.

Milestone #12 of the QFMP requires the QF to start operation within five years of the date of execution of the Power Purchase Agreement (PPA), "subject to the provisions of the PPA." We agree with PG&E that the current language of the QFMP contemplates changes to the on-line date. If deferral of a QF located in a transmission constrained area is in the ratepayers' best interests, it is reasonable to allow deferral of milestone #12. The QF is still obligated, however, to comply with all requirements and milestones under the QFMP in order to retain its priority.

2. <u>Need For Evidentiary Hearings</u>

Several commenters argue that the Commission should hold evidentiary hearings on some or all aspects of the proposed rulemaking before finalizing the guidelines. We disagree. The Commission is not required to hold evidentiary hearings in rulemaking proceedings. Nor would evidentiary hearings aid our

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18 We also encourage QFs to approach the joint QF-utility consultative committee as a forum for identifying problems, and attempting to resolve them. To the extent that the interconnection issues are generic, and require Commission resolution, the committee can be effective in bringing them to our attention through joint filings.

deliberations over the policies and principles in these guidelines. The comment procedure adopted in R.88-06-007 has provided us with a record appropriate to the task.

3. Exemptions From These Guidelines

In its comments, PG&E recommends two exemptions from these guidelines. First, we agree with PG&E that application of these guidelines is not appropriate for evaluating renegotiations with pioneer QFs (i.e., those generating under contracts signed before September 7, 1983). As PG&E points out, since the threshold test of a "pioneer" is economic distress, the pioneers would fail the viability test. In negotiating contract modifications with pioneers, utilities are expected to follow the guidance provided in D.87-08-047, and any subsequent guidelines specifically developed for pioneers.

Second, we agree with PG&E that negotiated modifications to a standard offer should be judged by the standards and circumstances in existence at the time the deals were made. However, we decline to excuse utilities from considering viability and other principles articulated in these guidelines just because the deal was made before the effective date of this order. The utility is obligated to use its best judgment in negotiating on behalf of ratepayers. This includes a careful evaluation of the risks and benefits at the time that deals are being negotiated. Utilities should have been considering the relationship between project viability and ratepayer risks/benefits prior to this point in time. Not only was this a topic brought up by participants during the SB 1970 hearings, and extensively discussed in the Joint CEC/CPUC Report, but it has also been discussed in prior Commission orders.[19]

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19 See, for example, D.88-03-036, page 7 (mimeo.) and Finding of Fact 5 in that decision.

4. Pre-Approval of Negotiated Modifications

Several of the commenters request clarification of how the Commission will review contract modifications for reasonableness, and the extent that these guidelines will eliminate the need for prospective review. We reiterate our position that the guidelines adopted in this order should eliminate the need for either utilities or QFs to seek advance approval or adjudication of most contract modifications. We expect that such modifications will be reviewed only retrospectively in ECAC proceedings. The primary exception, as outlined in these guidelines, are modifications that involve paid deferrals or contract buyouts. These will be reviewed for the time being only on a prospective basis.

Findings of Fact

1. On June 8, 1988, the Commission issued R.88-06-007, an OIR requesting written comments on a proposed set of contract administration guidelines for standard offers.

2. Comments responding to R.88-06-007 were filed by the CEC, CalCECI, CSC, SPP, Energy Growth, Shelton, IEP, BPC, PG&E, SDG&E, SCE, IPC, PSPC, and the DRA.

3. BPC, IPC, and PSPC failed to file their comments by July 15, 1988 as ordered in the ALJ's ruling dated July 1, 1988.

4. Both IPC and BPC made sincere efforts to file their comments on time, by sending a representative to file the documents in person, by close of business. Both filed motions to accept the late-filings with declarations stating the circumstances for failure to file on time.

5. PSPC was aware of the filing requirement but chose to mail comments on July 15, 1988. PSPC did not make any extra effort to meet the filing deadline or to file a motion.

6. The corrections to CalCECI's comments, filed by CalCECI after the comment period, were nonsubstantive.

7. The comments filed reflect a wide range of opinion regarding the philosophy, as well as the specifics of the proposed guidelines.

8. The standard offer contract entitles a QF to the payment terms of that offer so long as a QF can meet all the terms and conditions of its contract.

9. QFs do not have an automatic right to modify a standard offer--nor do utilities have an obligation to agree to any and all requested changes to a standard offer.

10. Implicit in the assessment of ratepayer benefits to any modification of a standard offer is the assumption that a QF is viable under the terms of its unamended contract.

11. A QF can be in various stages of project development and still be in compliance with the QFMP.

12. Determination of a QF's viability cannot be effectively evaluated with a "checklist" approach, where every aspect of the project's fuel supply, construction, financing, permits, and other viability criteria must be finalized before a QF is considered for contract modifications.

13. Requiring negotiated settlements of disputes over viability, even if the utility is convinced of nonviability, puts the utility and ratepayer in an untenable position.

14. These guidelines, in and of themselves, do not create a bargaining climate that differs from the current environment in which QFs enter into contracts and negotiate modifications.

15. In D.82-01-103, we made clear our requirement that the utility respond to proposals/inquiries and negotiate in good faith with QFs.

16. As the five-year on-line date approaches, the utilities are in a much better position to control the timing of negotiations, which can work to the detriment of QFs.

17. A QF needs to know where it stands on threshold issues, such as viability, in order to proceed expeditiously in the case of a dispute.

18. A utility found not to have bargained in good faith stands in violation of the Commission's orders.

19. Delays or uncooperativeness on the QF's part results in a protracted review/negotiation process, which works to the QF's disadvantage.

20. Guidelines are advisory in nature. Their primary function is to provide policy guidance over a wide range of specific circumstances.

21. Utilities are held to a standard of reasonableness based upon the facts that are known or should be known at the time the utility makes a decision.

22. The value of a certain contract modification or concession (e.g., deferrals and performance concessions) is not always evident by just using the "unamended contract" as a reference.

23. A utility that requires concessions disproportionate to the modifications requested by the QF violates Commission policy.

24. It is difficult to distinguish clearly between contract interpretation issues and contract modifications.

25. A change in the cogenerator's thermal host may suggest a significant revision to the project scope.

26. The mere presence of a change in site, thermal load fuel, plant size, cogenerator's thermal host or prime mover technology does not render it automatically significant enough to consider a project "essentially new."

27. Allowing the transfer of a standard offer contract to a new project eliminates the developer's risk, to the detriment of QFs.

28. The Commission did not address the issue of which execution date starts the five-year requirement in D.86-10-038, D.85-06-163, or any other decision issued by the Commission.

29. Under the language of PG&E's Interim Standard Offer #4, the effective date of the contract is the last signature date.

30. A QF cannot approach financing institutions, fuel suppliers, government entities, or otherwise pursue project development without a fully executed contract.

31. Force majeure is a legal doctrine that refers to uncontrollable or unforeseeable circumstances or actions which would relieve one party of a contract from certain obligations.

32. Under the force majeure provisions of standard offers, a party is excused from performance to the extent that it has notified the other party of the occurrence, suspended its performance only for the period required by the force majeure, and used its best efforts to remedy its inability to perform.

33. A project may be delayed as a result of force majeure but still be able to begin operation prior to the five-year deadline.

34. In D.83-10-093, the Commission excused a QF from the full burden of nonperformance in the face of "unanticipated" or "unforeseeable" actions by legislative, judicial, and regulatory agencies.

35. Not all government orders and regulatory actions are unanticipated or unforeseeable.

36. Most project delays resulting from delays in obtaining required permits are common events, and should be anticipated when the developer signs a standard offer.

37. The inability to obtain transmission capacity in PG&E's designated area of transmission constraints was foreseeable at the time of contract execution.

38. Deferral conditions, imposed by the CEC on projects within its jurisdiction, were not foreseeable when the current standard offer contracts were signed.

39. The effect of force majeure on the utilities' contract obligations depends upon the specific circumstances of each case.

40. A QF may be unable to comply with the QFMP due to a force majeure event.

41. The impact on ratepayers of excusing a QF for nonperformance and delaying the on-line requirement is potentially very significant.

42. Negotiated deferrals (paid or nonpaid) or buyouts, compared to any other type of contract modification, puts the ratepayer at greatest risk that the agreement breathes life into a moribund QF.

43. Paid deferrals puts the ratepayer in the position of financing QF projects in a "front loaded" fashion.

44. With paid deferrals and buyouts, ratepayers run the added risk that they are paying money for something they would have received for free.

45. The ratepayer benefits of a paid deferral or buyout are highly uncertain.

46. Even after permits/certifications are obtained, ratepayers still face some risk that a project would not have gone forward without the deferral/buyout.

47. Under the QFMP, a QF is entitled to maintain its interconnection priority as long as it complies with those procedures.

48. Milestone #12 of the QFMP contemplates amendments to the PPA, including deferrals of the on-line date.

49. The Commission is not required to hold evidentiary hearings under a rulemaking procedure.

50. The comment procedure adopted in R.88-06-007 has provided an appropriate record.

51. Pioneers would fail the viability test, since the threshold test of a pioneer QF is economic distress.

Conclusions of Law

1. PSPC's comments are not timely filed.

2. Guidelines for the administration of standard offer contracts are needed so that the Commission's policies are clarified and productive resolutions between parties may more easily be reached.

3. A modification of a standard offer agreement should only be agreed to if commensurate concessions are made to the benefit of ratepayers.

4. Modifications to a standard offer contract should not be negotiated with nonviable QFs.

5. Compliance with the QFMP, or a standard of "diligent pursuit" of a project is an insufficient viability standard.

6. In determining project viability, the utility should consider various aspects of project status as a whole, and the reasons for the current status of individual items, in light of the requested modifications.

7. A utility should not negotiate modifications as a settlement of disputes over viability unless there is a genuine question about the project's viability.

8. In implementing these guidelines the utility should negotiate in good faith and follow the specific standards articulated in D.82-01-103.

9. As the five-year deadline approaches, it is reasonable to impose specific time requirements on the utilities' responses to initial proposals/inquiries regarding contract modifications.

10. Explicit time restrictions or "burden of proof" language with regard to a QF's obligations are not needed.

11. It is unreasonable to expect guidelines to anticipate every situation which might arise in contract administration.

12. It is inappropriate to include specific criteria for judging future reasonableness, such as sources of input assumptions in guidelines.

13. The modifications and concessions obtained through negotiations should be valued with reference to the unamended contract and, where appropriate, the current and expected value of a QF's power.

14. Concessions sought by utilities in negotiating contract modifications should be commensurate in value with the degree of the change.

15. It would be a violation of our good faith requirement for utilities to "create" interpretation disputes as a means to force a QF to modify its contract, or to request disproportionate concessions in negotiating a settlement of interpretation disputes.

16. It is reasonable to include a change in the cogenerator's thermal host in the list of modifications that may suggest a project is "essentially new."

17. Where requested contract modifications would result in an essentially new project, those modifications should not be accepted.

18. This rulemaking is the appropriate proceeding in which to address the execution date issue raised by PG&E and others.

19. It is unreasonable to expect a QF to commence development activities prior to the effective date of the purchase power agreement.

20. The five-year requirement should begin after the agreement is signed by both the utility and the QF.

21. Under certain circumstances, force majeure may extend the five-year deadline without forfeiture of the standard offer contract.

22. Not all project delays resulting from delays in obtaining required permits are valid claims of force majeure.

23. Deferral conditions imposed by the CEC may give rise to valid claims of force majeure, depending on the specific circumstances.

24. The inability to obtain transmission capacity in PG&E's designated area of transmission constraints is unlikely to be viewed as a valid force majeure.

25. Any on-line date extension granted as a result of force majeure should be limited to the duration of the force majeure and the extent to which the QF can demonstrate that the force majeure impacted its ability to meet contract requirements.

26. The complex factual and legal nature of force majeure requires a case-by-case approach.

27. Utilities should carefully scrutinize each claim of force majeure, consistent with these guidelines, and negotiate only in instances where it is convinced that a settlement is in the best interest of ratepayers.

28. It is inappropriate to add language that adds compliance with the QFMP, in addition to "all contractual requirements in claiming the protection of force majeure" under Guideline III paragraph.

29. Extensions of the on-line requirement should be allowed only when deferrals are explicitly negotiated.

30. The threshold test of viability for all deferrals (paid or nonpaid) and buyouts should be more stringent than for other types of modifications.

31. As a general rule, deferrals and buyouts should be considered only with QFs who have obtained all their necessary permits and certifications.

32. Utilities should be given the latitude to negotiate nonpaid deferrals when the ratepayers interest will be served demonstrably better by such deferral.

33. Paid deferrals and buyouts should be subject to the Commission's pre-approval on a case by case basis.

34. It would be unreasonable to direct any utility to unilaterally "purge" the interconnection priority list based on an assessment of viability under these guidelines.

35. Resolution of interconnection disputes is beyond the scope of this rulemaking.

36. It is reasonable to allow deferral of milestone #12 if an on-line date deferral is negotiated.

37. Evidentiary hearings are not necessary for finalizing our guidelines.

38. In negotiating contract modifications with pioneers, utilities should follow the guidance provided in D.87-08-047, and any subsequent guidelines specifically developed for pioneers.

39. Negotiated modifications to a standard offer should be judged by the standards and circumstances in existence at the time of the negotiations.

40. The guidelines adopted in this order are reasonable.

41. The guidelines adopted in this order should eliminate the need for either utilities or QFs to seek advance approval or adjudication of most contract modifications.

O R D E R

IT IS ORDERED that:

1. The motions filed by Independent Power Corporation, Bonneville Pacific Corporation, and California Energy Company Inc. are granted.

2. The Guidelines for the administration of standard offer contracts, as revised by this decision and presented in Appendix A, are adopted.

3. From the effective date of this order until April 1, 1990, utilities must respond to a proposal for contract modification of a standard offer within 30 calendar days of the receipt of the QF's initial proposal or inquiry. This order applies to proposals for modifying the contract language and inquiries with regard to contract language interpretation. Throughout the negotiating process utilities are required to

respond to a QF's counterproposals and inquiries in a timely manner.

4. Consistent with the "good faith" standards articulated in D.82-01-103, and reiterated in this decision, when a utility is unwilling or unable to accept a QF's proposal, the utility's response must contain either a counteroffer or an explanation of:

1. The specific information needed to evaluate the proposal;
2. The precise difficulty encountered in evaluating the proposal;
3. The estimated date when it will respond to the proposal.

This order is effective today.

Dated OCT 14 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

Victor Weisser, Executive Director

APPENDIX A
Page 1

FINAL GUIDELINES FOR CONTRACT ADMINISTRATION OF STANDARD OFFERS*

I. GENERAL CONTRACT MODIFICATIONS

1. Contract modifications requested by QFs must be accompanied by price and/or performance concessions (e.g., adders such as dispatchability, voltage support, and emergency availability), commensurate in value with the degree of the change in the contract (from minor to major). The modifications and concessions obtained through negotiation should be valued with reference to the unamended contract and, where appropriate (e.g., deferrals and performance concessions), the current and expected value of the QF's power.

II. CONTRACT BROKERING AND NEW PROJECTS

1. The Commission recognizes that valid circumstances may arise in which the holder of a standard offer contract may wish to assign that contract to another party. The Commission does not encourage, however, forms of contract brokering which take on a speculative character. Utilities negotiating agreements with new holders of assigned contracts should seek pricing and performance concessions commensurate with the contract modifications requested.

2. Where the project would not be viable under the original terms of the contract, the modifications should not be accepted.

*Additions to the proposed guidelines, issued on July 8, 1988, are underlined. Deletions are ~~struck out~~.

3. Where requested contract modifications would result in an essentially new project, the modifications should not be accepted. In considering whether or not the requested modifications represent an essentially new project, the utility must be mindful of its duty to deal in good faith with QFs.

(a) Modifications such as significant changes in site, thermal load, fuel, plant size, cogeneration thermal host, or prime-mover technology suggest that the project is new.

(b) Multiple modifications to a contract suggest that the project is new.

III. FIVE-YEAR ON-LINE DATE REQUIREMENT

1. The five-year on-line requirement in standard offer contracts should be enforced, and should begin when both the QF and the utility have signed the contract.

2. Exceptions may be appropriate where the QF has experienced a "force majeure" or "uncontrollable force" within the meaning of the QF's standard offer contract and has complied with all contractual requirements in claiming the protection of the force majeure clause.

3. Any extension of the five-year on-line requirement resulting from the occurrence of a qualifying force majeure will be limited by the duration of the force majeure and the extent to which the force majeure impacted the QF's ability to meet the contract requirements.

4. Decisions about the applicability of the force majeure clause will be made on a case-by-case basis. Factors to be considered will include an examination of the factual basis of the force majeure claim, the specific language of the contractual force majeure clause, and whether the QF has complied with applicable contractual requirements to give notice of the force majeure and to mitigate the delay caused by the force majeure. The effect of the force majeure on the utility's obligations under the contract will also be considered as cases arise.

5. Events giving rise to valid claims of force majeure may include delay in obtaining required governmental permits ~~(such as CEC siting permits)~~, depending on the circumstances of the individual QF. However, not all project delays resulting from delays in obtaining required governmental permits are valid claims of force majeure. Permitting delays and denials are a regular part of project development and should be anticipated by project developers. Contract deferral conditions imposed by the CEC on projects within its jurisdiction for resource planning purposes, unforeseeable at the time of contract execution, may also be considered force majeure. The inability to obtain transmission capacity in PG&E's designated area of transmission constraints is unlikely to be viewed as a valid force majeure.

6. In general, deferrals (paid or non-paid) and buyouts should be considered only with QFs who have obtained all of the permits and certification necessary to go forward with their projects. As with all other types of contract modifications, deferrals and buyouts are subject to the viability guidelines outlined under Section IV.

7. On-line date deferrals and/or contract buyouts may be considered only if the ratepayers' interests will be served demonstrably better by such deferral.

8. The reasonableness of contract deferrals and buyouts will be determined by evaluating the need for generating capacity, the length of deferral, the costs avoided by deferring or buying out unneeded capacity, and the benefits (both monetary and non-monetary) granted projects acceding to deferral or buyout.

9. Unless an on-line date deferral is specifically negotiated between the utility and the QF, contract modifications will not extend the five-year on-line date.

10. Prospective reviews by this Commission for paid deferrals and buyouts will be required. Applications for preapproval of paid deferrals or buyouts must include documentation demonstrating that the utility has examined information on project viability, consistent with these guidelines, and that the utility is satisfied that the QF is able to meet the original terms of the contract.

IV. VIABILITY

1. Examination of a QF's viability under the original contract is prerequisite to modifications to power purchase contracts. In considering the QF's viability, the utility must be mindful of its duty to deal in good faith with the QF.

2. No modifications to a power purchase contract should be made if, after a reasonable examination of the QF's viability, the QF is determined to be nonviable. In the event that a ~~dispute exists between the QF and the utility as to the~~ there is a genuine question of the QF's viability ~~of the QF~~, then negotiated modifications to the contract may constitute a reasonable settlement of the dispute, or the QF may choose to bring a complaint before the Commission.

3. To determine viability the utility should examine, and the QF should provide information on, various aspects of the QF's project development including, but not limited to, the following. Each aspect examined should be consistent with the terms of the original contract. In assessing a project's viability, the utility should consider these and other aspects as a whole, the reasons behind the current status of individual items, and in light of the requested modifications.

(a) A completed Project Description and Interconnection Study Cost Request form.

(b) Proof of site control as defined in the QFMP.

(c) Commencement of the detailed interconnection study for the project.

(d) Proof that the $5/kw project fee has been established in an escrow account or letter of credit for the project pursuant to the QFMP or an explanation of why the QF has chosen not to establish the project fee and interconnection priority.

(e) Proof of permit status, such as a letter from the permitting agency accepting the QF's permit application for review and any additional information pertaining to the permit status.

(f) Proof of fuel supply, such as evidence of the existence and term of the fuel contracts.

(g) Evidence of feasibility of project construction and operation within the five-year deadline, such as a construction contract if one exists.

(h) Status report of equipment procurements including equipment procurement contracts.

(i) Status report of engineering and design.

(j) Status report of project financing, including lender's commitment, conditional or otherwise.

(k) Status of economic viability of the project by submission of a cash flow analysis.

(l) Evidence of the QF's prior track record on project development.

V. EXEMPTIONS

These guidelines do not apply to "pioneer" QFs. In negotiating contract modifications with pioneers, utilities should follow the guidance provided in D.87-08-047, and any subsequent guidelines specifically developed for pioneers.

(END OF APPENDIX A)

ALJ/MG/vdl

Decision ___________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking to Establish Guidelines for the Administration of Power Purchase Contracts Between Electric Utilities and Qualifying Facilities.	)	R.88-06-007 (Filed June 8, 1988)

changes to the contract. Otherwise, IPC argues, "a change without consequence would become a vehicle by which virtually to extort a change of consequence."

Energy Growth requests that the guidelines clearly distinguish between matters of contract modifications (which would require concessions on the part of the QF) from those of contract interpretation. Energy Growth argues that for issues of contract interpretation (e.g., execution date, change of site within the same parcel of land) a utility should not demand rate concessions equivalent to those that would be required as a condition for obtaining a contract modification.

B. Viability (Guideline Section IV)

In the proposed guidelines, the language requires that, as a prerequisite, a QF must be "viable" under its original standard offer before any contract modifications can be made. Paragraphs 3(a)-(j) provide a list of project status items that the utility should examine in determining viability. If disputes arise over the issue of viability, the guidelines provide for "negotiated modifications" as a reasonable settlement of the dispute. Alternatively, the QF may bring a complaint before the Commission.

Most commenters generally supported the objective of this guideline, namely, to prohibit "breathing life" into moribund projects via contract modifications. However, the comments revealed significant differences of opinion regarding (1) the appropriate criteria for determining viability, (2) the extent to which disputes around this issue should be settled via negotiation, and (3) who should determine viability or bear the burden of proof.

1. **What Criteria Should Be Used to Determine Viability?**

Several commenters support the proposed criteria for determining project viability without any changes (e.g., DRA, SCE, SPP, CEC, SDG&E). PG&E recommends adding an "economic viability" determination of its nonviability would enable a QF to negotiate modifications to the contract as a "reasonable settlement of the dispute." DRA proposes language changes to clarify that the utility should agree to modifications as a settlement only if the utility is satisfied that there is a genuine question of the QF's viability.

Similarly, SCE is concerned that the proposed language, as written, would force the utility to negotiate contract modifications, even if the utility is convinced of nonviability, and risk disallowance in ECAC. SCE recommends that the entire second sentence (including reference to the complaint process) be deleted.

3. Who Should Determine Viability And Bear the Burden of Proof?

CSC and CalCECI object to placing the utilities in the role of determining viability. CSC argues that the proposed guidelines effectively force the QF to resort to the Commission's complaint or other enforcement procedures, thereby creating unequal negotiating power between the QF and utility.

CSC and others argue that, if a guideline must be adopted, then it should establish a rebuttal be presumption that a QF is viable unless demonstrated otherwise by the utility.

SCE, on the other hand, believes that the burden should be on the QF to establish viability under the terms of the unamended contract. SCE argues that this "burden of proof" provides insurance that the QF will cooperate and provide information adequate for the utility to determine viability.

PG&E recommends revising paragraph 1 to include reference to the QF's duty to deal in good faith. In addition, PG&E would add language to make any negotiated amendment null and void should the QF misrepresent or fail to disclose a material fact concerning the project status.

on the resource planning process. Standard offers designed to provide longer-term price certainty to QFs are based on projections of the resource needs of utilities at the time they are developed.[5] Inevitably, those projections will involve some degree of error. Consistent with our principle of "a deal is a deal," we will not penalize the QF who can actually come on line under standard offer terms that might not, given today's realities, be offered to future QFs.

However, we draw the line where a QF's viability is in question. Nonviable QFs that signed up under standard offers reflecting relatively high projections of energy and capacity needs should not be able to "hold on to" or "broker" their contracts as updates to the standard offers yield less favorable terms. We agree with DRA that, from a resource planning perspective, the ratepayer would prefer terminating the failed project. The utility would then pursue negotiations with another resource (including QFs) at prices and terms that reflect the current resource planning realities. Further, the importance . . .

Also, a fundamental premise of the QF program is that the QF developer assumes <u>all</u> development risks. The ratepayer does not bear the burden of delay and cost overruns. This premise was one of the main justifications for paying the QF <u>full</u> avoided costs.

AB

5 Standard Offer #2 and Interim Standard Offer #4 are called "long run" offers because they offer fixed prices (for energy, capacity, or both) for a period of 10 to 30 years, while the "short run" standard offers (#2 and #3) pay only variable prices based on the current values of energy and capacity. While Interim Standard Offer #4 was developed in a negotiating conference, rather than our current OIR 2 evidentiary process, implicit in those negotiations were the participants' expectations concerning future trends of energy prices and resource needs.

the likelihood that a project will meet the original terms of its standard contract.

The QFMP procedure was developed to establish interconnection priorities in transmission-constrained areas, and to improve overall communication of project status between the QF and the utility. For that purpose, the compliance requirements promote continuing communication of a QF's intent to proceed. For QFs proceeding under the original terms of their standard offer, this approach is an effective one. However, we reject the notion that compliance with the QFMP, or the standard of "diligent pursuit" of a project is a sufficient prerequisite for any and all modifications of a standard offer.

IEP raises the concern that the "checklist" of viability criteria in Section IV. 3 of the proposed guidelines will be misused or misinterpreted. IEP describes situations where a modification may be needed due to transmission constraints (e.g., partial allocation of transmission requiring down-sizing) or permitting requirements (e.g., permits contingent upon change of fuel or size, or both). Under both types of circumstances, a "diligent" QF (i.e., one that is in compliance with the QFMP and actively pursuing project development) may need a contract modification to ensure continued viability. The status of some of the items listed under IV. 3 may be contingent upon approval of that change.

We agree with IEP that each QF need not have every aspect of the project's fuel supply, construction, financing, and permits finalized before a utility can consider a requested modification. The utility needs to consider these and other aspects as a whole the reasons behind the current status of individual items in light of the requested modifications. As IEP points out, there may be certain circumstances where the determination of a QF's viability is more subtle, and cannot be evaluated with a "checklist" approach. For this reason, we will add language to clarify that the items presented under Section IV. 3. are not to be interpreted to suggest that each item is separate from and independent of the others. However, as discussed above, we retain items from that list that are not contained in the QFMP.

We also add IEP's suggestion that utilities consider the QF's prior track record on project development and PG&E's suggestion that the QF submit a cash flow analysis. In all cases, however, we emphasize that the status of each item be considered to develop a total picture of a QF's viability; an item should not be administered as an "all or nothing" screening device.

Several commenters also suggested changes or requested clarification of our intent regarding the resolution of disputes over viability. We do not force the utility to negotiate contract modifications if the utility is convinced of nonviability. Instead, we provide a forum for settlement only if the utility is satisfied that there is a genuine question of a QF's viability. We will add language clarifying that intent.

We do not believe that the proposed guidelines, in and of themselves, create a bargaining climate that differs from the current environment in which QFs enter into contracts, and negotiate contract modifications. As in the past, the QF can enter into a standard offer agreement at its sole option, without negotiating terms and conditions with the utility. Where a QF chooses to negotiate a nonstandard offer, or modify a standard offer, the utility is required to respond to proposals and negotiate in good faith. This has not changed. We reiterate our expectations that utilities deal in good faith with the QF in all contract negotiations (see Guideline IV).

Several commenters have requested that we impose explicit time restrictions on negotiations, or otherwise make allowances for the time involved in the negotiation process. For example, Energy Growth recommends that both utilities and QFs be required to respond to each other's inquiries within 10 working days. Energy to accept a QF's proposal, the utility's response must include either an explanation of:

1. The specific information needed to evaluate the proposal; or
2. The precise difficulty encountered in evaluating the proposal; or
3. The estimated date when it will respond to the proposal.

We are unwilling to dictate specific time schedules beyond this 30-day requirement. Throughout the negotiating process, however, utilities are expected and will be required to respond to inquiries on a timely basis, and to provide the information outlined above. As in the past, the Commission will entertain formal complaints raised by QFs who can demonstrate that the utility has failed to bargain in good faith, since a utility found not to have bargained in good faith stands in violation of the Commission's orders.

With regard to the QF's obligations, we do not believe that explicit time restrictions or "burden of proof" additions are necessary. The QF already has a strong incentive to provide information that is adequate and accurate for a utility's review. Delay or uncooperativeness on the QF's part only results in a protracted review/negotiation process, which works to the QF's disadvantage.

B. General Contract Modifications

Several commenters urge us to expand the language of Guideline I to include specific criteria for judging reasonableness at a future date, including sources of input assumptions. We disagree. The guidelines we are issuing today are, as in the past,

> <u>in breach of contract as a result of those changes</u>. (Emphasis added.)[15]

Our intent was to excuse the QF from "unanticipated" changes in the law, and to prevent the utilities from being placed in the untenable position of being bound to a contract that violates the law.

We do not change that policy. We agree with CEC, DRA and SCE, however, that not all government orders and regulatory actions are "unanticipated" or "unforeseeable," thereby qualifying as a force majeure event under the standard offers. In particular, we agree with DRA and SCE that most permitting delays are common events and should be anticipated by project developers when they commit to deliver power to a utility. We add language to that effect.[16]

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DRA argues that deferral conditions imposed by CEC are also probably foreseeable, and should not be specifically identified as a valid claim of force majeure in our guidelines. We disagree. In the Joint CEC/CPUC Report, the two Commissions concluded that this type of license condition was not forseeable when the standard offer terms were signed. We continue to support that conclusion. Similarly, we support the conclusion that it was foreseeable that a QF in PG&E's transmission-constrained area might not be able to obtain the necessary transmission capacity.

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15 D.83-10-093, page 81, mimeo.

16 Edison also proposes language requiring the QF to be in compliance with the QFMP, in addition to "all contractual requirements in claiming the protection of the force majeure clause" under Guideline III, paragraph 2. This would only be appropriate if the contract language explicitly required compliance with the QFMP to excuse a QF's performance under force majeure. This is not the case. Further, compliance with some of the specific time requirements of the QFMP (e.g., start of construction) may be rendered impossible by the force majeure event. We reject Edison's proposed requirement.

7. The comments filed reflect a wide range of opinion regarding the philosophy, as well as the specifics of the proposed guidelines.

8. The standard offer contract entitles a QF to the payment terms of that offer so long as a QF can meet all the terms and conditions of its contract.

9. QFs do not have an automatic right to modify a standard offer--nor do utilities have an obligation to agree to any and all requested changes to a standard offer.

10. A fundamental premise of the QF program is that the QF developer assumes all development risks.

11. Implicit in the assessment of ratepayer benefits to any modification of a standard offer is the assumption that a QF is viable under the terms of its unamended contract.

12. A QF can be in various stages of project development and still be in compliance with the QFMP.

13. Determination of a QF's viability cannot be effectively evaluated with a "checklist" approach, where every aspect of the project's fuel supply, construction, financing, permits, and other viability criteria must be finalized before a QF is considered for contract modifications.

14. Requiring negotiated settlements of disputes over viability, even if the utility is convinced of nonviability, puts the utility and ratepayer in an untenable position.

15. These guidelines, in and of themselves, do not create a bargaining climate that differs from the current environment in which QFs enter into contracts and negotiate modifications.

16. In D.82-01-103, we made clear our requirement that the utility respond to proposals/inquiries and negotiate in good faith with QFs.

17. As the five-year on-line date approaches, the utilities are in a much better position to control the timing of negotiations, which can work to the detriment of QFs.

18. A QF needs to know where it stands on threshold issues, such as viability, in order to proceed expeditiously in the case of a dispute.

19. A utility found not to have bargained in good faith stands in violation of the Commission's orders.

20. Delays or uncooperativeness on the QF's part results in a protracted review/negotiation process, which works to the QF's disadvantage.

21. Guidelines are advisory in nature. Their primary function is to provide policy guidance over a wide range of specific circumstances.

22. Utilities are held to a standard of reasonableness based upon the facts that are known or should be known at the time the utility makes a decision.

23. The value of a certain contract modification or concession (e.g., deferrals and performance concessions) is not always evident by just using the "unamended contract" as a reference.

24. A utility that requires concessions disproportionate to the modifications requested by the QF violates Commission policy.

25. It is difficult to distinguish clearly between contract interpretation issues and contract modifications.

26. A change in the cogenerator's thermal host may suggest a significant revision to the project scope.

27. The mere presence of a change in site, thermal load fuel, plant size, cogenerator's thermal host or prime mover technology does not render it automatically significant enough to consider a project "essentially new."

28. Allowing the transfer of a standard offer contract to a new project eliminates the developer's risk, to the detriment of QFs.

29. The Commission did not address the issue of which execution date starts the five-year requirement in D.86-10-038, D.85-06-163, or any other decision issued by the Commission.

30. Under the language of PG&E's Interim Standard Offer #4, the effective date of the contract is the last signature date.

31. A QF cannot approach financing institutions, fuel suppliers, government entities, or otherwise pursue project development without a fully executed contract.

32. Force majeure is a legal doctrine that refers to uncontrollable or unforeseeable circumstances or actions with would relieve one party of a contract from certain obligations.

33. Under the force majeure provisions of standard offers, a party is excused from performance to the extent that it has notified the other party of the occurrence, suspended its performance only for the period required by the force majeure, and used its best efforts to remedy its inability to perform.

34. A project may be delayed as a result of force majeure but still be able to begin operation prior to the five-year deadline.

35. In D.83-10-093, the Commission excused a QF from the full burden of nonperformance in the face of "unanticipated" or "unforeseeable" actions by legislative, judicial, and regulatory agencies.

36. Not all government orders and regulatory actions are unanticipated or unforeseeable.

37. Most project delays resulting from delays in obtaining required permits are common events, and should be anticipated when the developer signs a standard offer.

38. The inability to obtain transmission capacity in PG&E's designated area of transmission constraints was foreseeable at the time of contract execution.

39. Deferral conditions, imposed by the CEC on projects within its jurisdiction, were not foreseeable when the current standard offer contracts were signed.

40. The effect of force majeure on the utilities' contract obligations depends upon the specific circumstances of each case.

41. A QF may be unable to comply with the QFMP due to a force majeure event.

42. The impact on ratepayers of excusing a QF for nonperformance and delaying the on-line requirement is potentially very significant.

43. Negotiated deferrals (paid or nonpaid) or buyouts, compared to any other type of contract modification, puts the ratepayer at greatest risk that the agreement breathes life into a moribund QF.

44. Paid deferrals puts the ratepayer in the position of financing QF projects in a "front loaded" fashion.

45. With paid deferrals and buyouts, ratepayers run the added risk that they are paying money for something they would have received for free.

46. The ratepayer benefits of a paid deferral or buyout are highly uncertain.

47. Even after permits/certifications are obtained, ratepayers still face some risk that a project would not have gone forward without the deferral/buyout.

48. Under the QFMP, a QF is entitled to maintain its interconnection priority as long as it complies with those procedures.

49. Milestone #12 of the QFMP contemplates amendments to the PPA, including deferrals of the on-line date.

50. The Commission is not required to hold evidentiary hearings under a rulemaking procedure.

51. The comment procedure adopted in R.88-06-007 has provided an appropriate record.

52. Pioneers would fail the viability test, since the threshold test of a pioneer QF is economic distress.

respond to a QF's counterproposals and inquiries in a timely manner.

4. Consistent with the "good faith" standards articulated in D.82-01-103, and reiterated in this decision, when a utility is unwilling or unable to accept a QF's proposal, the utility's response must contain either a counteroffer or an explanation of:

1. The specific information needed to evaluate the proposal;
2. The precise difficulty encountered in evaluating the proposal; or
3. The estimated date when it will respond to the proposal.

This order is effective today.

Dated ________________, at San Francisco, California.