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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

UNION OIL COMPANY of CALIFORNIA, a California Corporation; TEXACO SYNGAS, INC., a Delaware Corporation; and FLUOR CARSON, INC., a California Corporation, Complainants, vs. SOUTHERN CALIFORNIA EDISON COMPANY, Defendant.	Case 87-01-023 (Filed January 14, 1987)

Messrs. Armour, St. John, Wilcox, Goodin & Schlotz, by James D. Squeri, Attorney at Law, for Union Oil Company of California, Texaco Syngas, Inc., and Fluor Carson, Inc., and Joseph P. Foley, Attorney at Law, for Texaco, Inc., complainants.
Richard K. Durant, Carol B. Henningson, and Julie A. Miller, Attorneys at Law, for Southern California Edison Company, defendant.
Howard V. Golub, Michael S. Hindus, and Jo Shaffer, Attorneys at Law, for Pacific Gas and Electric Company, interested party.
Thomas W. Thompson, for the Division of Ratepayer Advocates.

OPINION

I. Background

Union Oil Company of California (Unocal), Texaco Syngas, Inc. (Texaco), and Fluor Carson, Inc. (Fluor) (collectively referred to as complainants) filed a complaint against Southern California Edison Company (Edison) on January 14, 1987.

The general factual background to the complaint began in 1983 and grew out of the interest of Unocal, Texaco, and Fluor in developing a project to convert petroleum coke to electric power. Petroleum coke is a byproduct of crude oil refining. Texaco had developed a process for gasifying the coke. The gas could fuel cogeneration units, and hydrogen could be produced out of this entire process.

In 1984, Unocal and Edison executed a contract based on interim Standard Offer No. 4 (ISO4) for the sale of 70 MW from a coke-fired cogeneration facility at Unocal's ammonia plant in Brea. The federal Public Utility Regulatory Policies Act of 1978 (PURPA) requires utilities to purchase electricity produced by certain qualifying facilities (QFs), including cogeneration facilities, at the utility's avoided cost, or the costs the utility avoids by purchasing power rather than generating an equivalent amount of power from its own system. The standard offers, with terms and prices that we had found reasonable, are one of our efforts to comply with our responsibilities under PURPA. ISO4 provides a long-term certainty of price for QFs willing to enter into a long-term contract with the utility. Because the price of power purchased under ISO4 contracts available at this time was based on projections made in May and June of 1983, these contracts were particularly desirable when short-term avoided costs declined in parallel with falling oil prices and with an unexpected increase in the electric capacity available to utilities. We suspended the availability of ISO4 on April 17, 1985 (Decision (D.) 85-04-075).

After the contract was signed, local opposition in Brea led Unocal to consider pursuing the project elsewhere. It began to explore with Edison the possibility of relocating the project to Carson and assigning the contract to a new partnership consisting primarily of complainants.

Discussions with Edison continued for a while, but in September 1986 Edison informed Unocal that it would not consent to the assignment and relocation without a formal order from the Commission. When construction had not begun by the start-up date established in the contract, December 1, 1986, Edison exercised its contractual rights and terminated the contract.

The complaint concerns Edison's refusal: (1) to execute and consent to the assignment of the contract between Unocal and Edison to the new partnership; (2) to consent to an amendment of the contract to permit relocation of the underlying project from Brea to Carson; and (3) to extend the construction start-up date specified in the contract. The complaint asks the Commission to order Edison to execute the assignment of the contract, consent to the relocation, and extend, on a reasonable basis, the contract's construction start-up date.

Edison answered the complaint on February 26, 1987. In addition to the expected denials of complainants' allegations, Edison views the contract as a nonstandard, negotiated agreement with Unocal, rather than an ISO4. Edison affirmatively argues that the Brea project and the Carson project were two different projects, and that the Commission's decisions required Edison to obtain concessions in exchange for substantial changes in the contract in order to maintain ratepayer indifference. Edison denies that it negotiated in bad faith with complainants concerning the assignment and relocation. Edison further alleges that the complaint seeks relief--essentially an order to Edison to execute a nonstandard contract--that the Commission had previously stated it would not grant. Several defenses based in contract law are also raised. According to Edison, the requested relief would be inconsistent with the suspension of ISO4. Finally, Edison argues that permitting site switching and brokering of the contracts with QFs would create an undesirable precedent.

Complainants felt it necessary to file a reply to Edison's answer on March 18, 1987. The reply primarily addressed Edison's affirmative defenses.

A prehearing conference was held on May 5, 1987, and evidentiary hearings were held on September 24 and 25, 1987.. Pacific Gas and Electric Company (PG&E) and the Commission's Division of Ratepayer Advocates (DRA) intervened in the proceeding and participated in the hearings.

The procedures of Public Utilities Code Section 311(d) were followed in developing this decision. The proposed decision of the Administrative Law Judge was issued on February 2, 1989. Complainants and Edison filed comments on the proposed decision.

We have reviewed and carefully considered the comments. We have incorporated appropriate changes in this decision.

II. Positions of the Parties

A. Complainants' Position

Complainants first note that D.82-01-103 and D.83-10-093 imposed on utilities a duty to negotiate in good faith with QFs. Complainants believe that Edison breached its duty by repeatedly leading complainants to believe that Edison would consent to the requested assignment and relocation if complainants would comply with a specific Edison request. But each time complainants complied with a request, Edison posed additional conditions to its consent, culminating in Edison's September 1986 statement that it would not agree to the assignment and relocation without a formal order from the Commission, according to complainants. Complainants relied on Edison's apparent willingness to consent to the assignment and relocation, but eventually time ran out and the project was delayed until meeting the construction start-up date set in the contract was impossible. Edison promptly exercised its right of termination when the target construction start-up date passed.

Complainants believe that Edison misinterpreted the Commission's policies and that its insistence on insulation from any possible risk connected with the relocation was a further breach of its obligations.

Complainants reject Edison's attempts to characterize the issues in this case as involving contract brokering or site switching. According to complainants, a properly framed statement of the issues the Commission must resolve in this case is:

> "(1) Is the proposed Carson Cogeneration Project as well as the terms and conditions under which power sold from such a project would be sold to Edison in the interest of Edison's ratepayers?
>
> "(2) Given repeated representations by Edison that assignment/relocation of the Unocal Contract was appropriate, should Edison be required to execute a power purchase agreement consistent with Complainants' May 26 settlement offer?"

1. The Project's Benefits

Complainants answer their first question by listing the benefits that the Carson project will provide to Edison's ratepayers and other Californians.

First, the project will demonstrate several unique technologies: conversion of waste petroleum coke to clean-burning fuel gas; coproduction of hydrogen for upgrading heavy California crude oils to clean transportation fuels; coproduction of methanol for transportation fuels, clean-burning boiler fuels, and load following of combustion turbines; air pollution control technology that exceeds the current state of the art; and the capability to destroy completely waste oils and water effluents from refineries.

Second, the project will provide direct economic benefits to Edison's ratepayers. For this analysis, complainants have used the terms of a settlement they offered to Edison on May 26, 1987. Although complainants believe that they are legally entitled to assignment and relocation of the original Unocal contract, they have reduced their claim in the settlement offer because they believe that they may expect affirmative action from the Commission only if the project is found to advance the public interest and because ambiguities create different interpretations of the contract.

The original contract contained the following terms: 70 MW of firm capacity at $179 per kilowatt-year (kW-yr); 66 MW of as-available capacity; and energy associated with 136 MW at 9.8 cents per kilowatt-hour (kWh). The settlement offer contained the following terms: 70 MW of firm capacity based on $179 per kW-yr, escalated to $224 per kW-yr to account for delaying the firm operation date from 1989 to 1992; 66 MW of firm capacity at $103 per kW-yr; energy associated with 70 MW at 9.8 cents per kWh; and energy associated with 66 MW at 6.4 cents per kWh. Complainants' economic analyses are based on the latter terms.

Complainants have developed two analyses of short-run avoided costs, one based on Edison's projections of fossil fuel costs and the other based on projections of fossil fuel costs made by the California Energy Commission (CEC). Complainants also compared the costs and benefits of the settlement offer's 1992 firm operation date with the 1989 firm operation date of the original contract. Complainants believe that this comparison properly represents the ratepayers' perspective on this controversy.

This analysis shows that benefits ranging from $16.1 million to $57.7 million result when the settlement offer's terms are compared to the CEC's fuel price projections, and expected losses ranging from $24.2 million to $54.3 million result when Edison's projections are used. Complainants argue that viewing these results as best and worst cases, or using the midpoint of the ranges, results in estimates that, standing in isolation, are acceptable from the ratepayers' viewpoint.

Complainants think that consideration of other benefits swings the analysis in favor of their requested relief. The project provides insurance against higher oil prices. The success of the project will stimulate similar projects, which will provide a competitive alternate energy source tending to limit future oil price increases. In addition, the project will reduce emissions of oxides of nitrogen (NOx) in the Los Angeles basin; will allow fuel cost savings from burning methanol in Edison's combustion turbines or from overfiring in thermal plants; will result in reduction of off-peak power purchases due to load following using the methanol flywheel; and will reduce transmission losses because of the project's location near Edison's load center.

Complainants estimate the savings from NOx reductions and fuel cost savings to be $15 million and $45 million, respectively. No estimates have been made of the savings in off-peak purchases and transmission losses because of insufficient data.

Complainants conclude that the direct benefits to Edison's ratepayers justify granting the requested relief.

The project will also provide substantial indirect benefits to ratepayers and to other Californians, complainants say. For example, the project's success will stimulate additional projects with similar benefits. Complainants estimate the benefits of these subsequent projects for ratepayers to range from $80 to $310 million. Thus, complainants assert, the direct and indirect benefits to Edison's ratepayers total $95 million to $355 million.

Complainants also believe that the project will benefit Californians in general. First, the project will reduce oil imports and increase the in-state refining of California crude oil. Coke gasification also increases the proportion of heavy crude that can be converted to clean transportation fuels. The hydrogen that is a coproduct of the project is needed in large quantities to refine heavy crudes into unleaded gasoline, low sulfur diesel fuels, and jet fuels. Second, the project will demonstrate an alternative to natural gas as a domestic source for production of methanol. Third, the project will demonstrate an electric generation technology that exceeds current air pollution control standards. Fourth, the project will increase the state and local taxes by $25 million and increase employment by 800-1000 person-years during construction and by 90-100 permanent jobs.

Complainants acknowledge that such external benefits do not independently justify their requested relief, but they argue that such benefits should be considered by the Commission in reaching its decision in this case.

2. Edison's Conduct

The second prong of complainants' argument is that Edison's conduct and representations to complainants justify granting their requested relief. Complainants argue that they expended substantial time, effort, and money based on Edison's continued representations that complainants' efforts were entirely consistent with Edison's interests. Complainants believe that an examination of Edison's conduct leads to the conclusion that complainants are entitled to the requested relief.

Unocal began studying the feasibility of a coke gasification facility at its Brea plant in July 1983. In 1984, Fluor and Texaco began providing their services to the project. In 1984, Fluor, Texaco, and Edison formed a joint venture to study construction of a coke gasification project, called the Los Angeles Basin Coke Gasification Project. Many sites were evaluated, and in August 1984 the venture began to identify specific customers for the products of the project.

Unocal executed the power purchase agreement with Edison for the Brea project in December 1984. Execution of the contract stimulated local opposition to the project, and Unocal determined that relocation to the Los Angeles harbor area, where there is a concentration of coke production, would be preferable to remaining at the Brea site.

In February 1985, Unocal initiated discussions with Edison about the transfer of the Unocal contract to another site. At that time, Edison said it had no policy on such transfers. In

March 1985, Edison withdrew from the L.A. Basin Coke Gasification Project, but expressed an interest in rejoining the project when it was more developed. Fluor and Texaco continued development of the project.

At about the same time, Unocal, Texaco, and Fluor began discussions about jointly pursuing a coke gasification project, and these parties have worked together on the project since that time. Although no executed written agreements have formalized the joint arrangement, collateral agreements and the expenditure of tens of millions of dollars demonstrate a continuing and substantial commitment among the complainants to develop the Carson project.

Meanwhile, according to complainants, Edison was encouraging complainants to relocate the project. On June 26, 1985, one of Edison's senior managers advised Texaco that the Unocal contract could be relocated and that the Unocal contract was one of the few contracts that had such flexibility. In August 1985, Texaco initiated discussions with Edison concerning the assignment of the Unocal contract to the Unocal-Texaco-Fluor partnership, relocation of the project from Brea to Carson, and extension of the construction start-up date contained in the contract. Edison indicated that the construction start-up date would not be enforced as long as the deadline for the start of firm operation could be met and that the contract could be assigned to the partnership, complainants contend.

Negotiations on these topics continued. In meetings on February 12 and 13, 1986, the partnership again raised the problem of the construction start-up date, which at this time clearly could not be met because of continuing negotiations. According to complainants, Edison again stated that the construction start-up date would not be enforced.

On February 19, 1986, Unocal formally requested Edison's consent to assignment of the contract to the partnership and to relocation of the project to Carson. On March 6, Edison stated that it favored approving the assignment, but it reserved its final opinion until it had consulted the Commission's staff. Edison met with staff members on March 6. On April 1, Edison told the Commission's staff that it intended to proceed with the assignment and relocation, provided that the staff's representations made at the March 6 meeting remained in effect. The staff conveyed the required assurances to Edison, according to complainants.

Despite these assurances, Edison refused to execute the amendment to the contract to permit the assignment and relocation. Edison now required the approval of a Commissioner before it would consent to the assignment and relocation. On May 16, Edison met with Unocal and Texaco and approved the correspondence that would request the Commissioner's review and approval of the assignment and relocation. On July 17, Unocal submitted the request to Commissioner Calvo. Commissioner Calvo responded on July 29, with a letter stating that the assignment and relocation was consistent with the Commission's policies and was not unreasonable in light of the facts stated in the request.

On August 24, 1986, Edison informed Unocal that it would not consent to the assignment and relocation based on Commissioner Calvo's letter. On September 26, Edison told Unocal that it required a formal Commission order ratifying the reasonableness of Edison's consent before it would agree to the assignment and relocation.

Complainants argue that Edison misled them at every point until the statement in August that it would not consent to the assignment and relocation. Edison's argument that the terms of complainants' request were unclear or that the terms changed over time is belied by the April 1 correspondence from Edison to Commissioner Calvo's office, which accurately described the proposal in detail.

Complainants believe that the preceding facts compel rejection of Edison's arguments that it knew all along that the assignment and relocation was not in the ratepayers' interest; that Edison never entertained the possibility that it would voluntarily agree to the assignment and relocation; that Edison intended strictly to enforce the terms of the Unocal contract; and that Nola's April 1 correspondence represented only the opinion of an individual who had no authority to bind Edison.

Thus, complainants argue, Edison intended all along to terminate the contract, and Edison negotiated in bad faith by misrepresenting its intentions to complainants. At best, "Edison utterly failed to communicate its intentions to Complainants and negligently led Complainants down the path of meaningless and fruitless negotiations."

Because the Carson project is in the public interest and in light of Edison's conduct, complainants ask the Commission to order Edison to execute a power purchase agreement based on the settlement offer of May 26.

B. Edison's Position

In Edison's view, this case involves two separate projects, the Unocal Brea project and the Texaco/Fluor project. The Texaco/Fluor project was not sufficiently defined to allow an ISO4 contract to be signed before the Commission suspended ISO4 on April 17, 1985. The request for the assignment of the Unocal contract first came after the suspension of ISO4.

Edison negotiated with the complainants to develop a contract that was in the ratepayers' interest. When these efforts proved unsuccessful, however, it notified complainants that it would not agree to assign the Unocal contract without obtaining further benefits for ratepayers. When the start-up date called for in the contract passed without the start of construction, Edison exercised its contractual right to terminate the agreement.

Edison believes that this case presents a clear test of the Commission's policy on contract brokering and site switching.

1. Factual Background

Edison's view of the facts of this case differ from complainants' in several key respects.

First, Edison views the Unocal contract as a nonstandard contract, since Unocal requested and obtained several changes from the standard offer. Edison believes the contract was for a 136 MW cogeneration project, with 70 MW of firm capacity and associated energy to be sold to Edison and the remaining 66 MW to be used on site.

The Texaco/Fluor venture was an entirely separate project, in Edison's opinion, that did not mature fast enough to qualify for an ISO4 contract before the suspension. After the suspension, Edison informed Texaco and Fluor that any further negotiations would have to be based on the terms of Standard Offer No. 2 (SO2), which remained in effect. The proposal to assign the Unocal contract followed.

Edison negotiated with the complainants, in hopes of incorporating dispatchability and voltage support in the contract. By August 1986, Edison became convinced that the operating characteristics of the Carson project would not permit dispatch. At the same time, falling energy and capacity price forecasts convinced Edison that the project would not provide economic benefits to Edison's ratepayers. Edison informed the partnership of its conclusion at the August and September meetings.

Edison did not regard the letter from Commissioner Calvo as providing sufficient assurance to justify the assignment and relocation. Although the letter generally supported the project, key language on the reasonableness of Edison's proposed action was vague.

Because of the lack of ratepayer benefits, Edison would not consent to the assignment and relocation of the project, even today, without a direct order from the Commission.

2. Edison's View of the Issues

Edison also differs with complainants in its view of how the issues in this case should be defined. Edison believes that in order to grant the requested relief, the Commission must agree with complainants that Edison negotiated in bad faith and that the appropriate equitable remedy is to assign the Unocal contract to the Carson project. Moreover, Edison argues that the Commission need not reach the issue of bad faith if it finds that the proposal is not in the ratepayers' interest or that the requested relief is inappropriate. Edison believes that granting the requested relief would create a very bad precedent for future transactions with other QFs.

3. Edison's Conduct

Edison says that it did not negotiate in bad faith. The duty to negotiate in good faith with QFs was created in D.82-01-103. The nature of this duty was stated very clearly:

> "When the utility is unwilling or unable to accept a QF's proposal, the utility must respond with a timely counteroffer, or an explanation...of:
>
> "1. The specific information needed to evaluate the proposal;
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> "2. The precise difficulty encountered in evaluating the proposal; and
>
> "3. The estimated date when it will respond to the proposal." (D.82-01-103, 8 CPUC 2d 20, 85.)

Edison believes it has met this duty. For example, Edison explained why it was refusing the partnership's proposed amendments, as detailed in the testimony of its witness

John Bunnell, and it made a counteroffer based on SO2. Edison believes that complainants are trying to assert that investigating a proposal and attempting to work out a solution is bad faith if a solution cannot be reached. In essence, complainants' thesis is that the utility cannot break off preliminary negotiations. Case law and the relevant literature have rejected this notion.

Edison also rejects complainants' assertions that they had met all conditions that Edison had established for its consent to the assignment and relocation. Several important elements of Edison's negotiating package--dispatchability, voltage support, and other operating benefits--were never agreed to by complainants. Edison did not finally reject complainants' proposal until it became clear that complainants were not willing to include these important benefits for ratepayers in the amendments.

Moreover, Unocal should have been aware all along that it bore the risk that the project would not be developed, Edison argues. The contract clearly gave Edison the right to terminate if the construction start-up date was not met, and the contract also required a waiver of any of the contract's provisions to be in writing. The contract clearly placed the risk that the project would not go forward on Unocal.

4. <u>The Requested Relief</u>

Edison also argues that the relief requested by complainants is inequitable and inappropriate.

The relief is procedurally inappropriate because complainants' request, in essence, is an application for review of a nonstandard contract. The Commission has ruled that only the utility may file for review of a nonstandard contract. Furthermore, the Commission has ruled that it does not intend to intervene in or rewrite contracts, which is precisely the relief that complainants request.

In addition, the terms of the requested relief are in dispute. Edison believes that complainants' claim to ISO4 prices for the energy associated with the full 136 MW of the Unocal project is merely a strawman constructed to make the settlement offer seem more reasonable. Under Edison's view of the Unocal contract, the price of energy in the settlement offer would actually exceed the price in the original contract. Edison believes that complainants' attempt to get the Commission to approve its proposal is an effort to negotiate with the Commission rather than with Edison.

The requested relief is also inconsistent with the Commission's policy, according to Edison. Granting the relief would amount to compelling the utility to purchase power at prices greater than its avoided cost, in violation of Section 210 of PURPA. As noted previously, Edison thinks complainants' claim of bad faith is merely an attempt to bring an application for a new nonstandard contract before the Commission, as complainants' counsel essentially acknowledged in his opening statement. The Commission has also stated its policy that the guiding standard for review of nonstandard contracts is the economic indifference of ratepayers; that is, the nonstandard agreement should be the economic equivalent of a comparable standard offer. Even if complainants' economic analyses are accepted at face value, ratepayers are not indifferent to this contract because of the great detriment that ratepayers would incur if a precedent allowing contract brokering and site switching were to emerge from this case.

In Edison's opinion, this case presents a clear test of the Commission's policy on site switching and contract brokering. Edison points out that DRA's proposed guidelines on negotiating ISO4 contracts would not permit complainants' proposed amendments. The facts show that this complaint is an attempt to transfer a contract from the original project to a different project, the definition of contract brokering, according to Edison. The Carson project differs from the Brea project in numerous ways: the identity of the participants, the date of the start of construction, the project's size and location, the technology to be used, the use of the recovered heat from the cogeneration process, the interconnection point with Edison's system, the amount of power to be purchased by Edison, the project's design, and the fuel or energy source. Moreover, it is clear that the project cannot succeed under the terms of the original contract without a number of material changes to reflect these differences.

5. The Project's Cost to Ratepayers

Edison calculates that the project's costs for ratepayers exceed its benefits by about $140 million. The calculations are based in part on Edison's rejection of complainants' contention that unquantifiable societal benefits justify payment of more than the current avoided cost. Edison points out that complainants have admitted that the project would not be built if payments were limited to current avoided cost. Edison also believes that this issue has previously been decided by the Commission:

> "Further, while societal considerations have always been important to the Commission, we do not view the development of avoided costs as an avenue for determining whether certain technologies or owners should receive preferential financial assistance based on overall societal benefits. There are undoubtedly proponents of other worthwhile projects who could and would argue that their projects provide equally important benefits to society. Opening the standard offer process to consideration and resolution of such broad policy issues would unnecessarily complicate, politicize, and lengthen what is already a cumbersome process." (D.85-07-021, mimeo. pp. 31-32.)

Edison is willing to honor the original contract, although it estimates that this contract would cost ratepayers between $135 million and $200 million in overpayments. Edison believes that the Brea project is not viable, and it argues that to permit the project to move to the Carson site would ensure that ratepayers would in fact incur those overpayments.

Even the May 26 settlement offer would cost ratepayers $61 million, according to Edison's calculations. Branchcomb's analysis was flawed because it compared only the choice between a 1989 on-line date and a 1992 on-line date for the project. Edison's estimates are based on a comparison of the project's costs with the current avoided cost during the period of operation under the settlement offer, 1992-2012. It performed six sensitivity analyses that convinced it that ratepayers should not incur the risks associated with the settlement offer.

Finally, Edison argues that the Commission should not undermine Edison's management discretion to negotiate with QFs by forcing Edison to accept the settlement offer.

C. <u>Other Parties' Positions</u>

1. <u>DRA's Position</u>

DRA opposes complainants' requested relief. DRA argues that the relocated project would be a wholly different project from the Brea project contemplated in the original contract, and that granting complainants' request would allow brokering of the contract. In addition, DRA believes that the amended contract requested by complainants would not leave ratepayers indifferent and thus would fail one of the important tests the Commission has applied in similar situations.

DRA acknowledges the physical similarity of the two projects, but, like Edison, DRA notes the change in Unocal's participation in the Carson project. At Brea, Unocal would have received synthesis gas, process steam, and electricity for its own use, but at Carson Unocal would receive only the profits from the sale of electricity. This difference, among others, persuades DRA that the two projects are distinct.

DRA argues that ratepayers would face increased risk under the contract requested by complainants. Like the original contract, the amended contract would require payments of $179 per kilowatt-year for 70 MW. But the amended contract would also fix payments at $103 per kilowatt-year for an additional 66 MW. Fixing the price for the additional payments is an added risk for ratepayers, and one that DRA does not feel that ratepayers should bear.

According to DRA, the discussion of the benefits of the Carson project is irrelevant to the resolution of the complaint, because of DRA's conclusion that the two projects are separate and distinct. Complainants have no right to an amended contract, DRA concludes.

2. PG&E's Position

This case presents a clear example of the issue of brokering of IS04 contracts, in PG&E's view. PG&E believes that Unocal is trying to sell its IS04 contract for $10 million to the partnership formed by complainants. The record is clear that Texaco and Fluor were not participants in the Brea project, and PG&E believes that they are currently seeking Unocal's IS04 because they were unable to obtain an IS04 for the Carson project before the offer was suspended. PG&E notes that Texaco first approached Unocal within a few weeks of the suspension of IS04.

The true nature of this sale is revealed in the letter agreement of January 27, 1986 (Ex.6), and the draft partnership agreement (Ex. 7). According to PG&E, these documents make clear that Unocal's sole capital contribution to the partnership would be the assignment of its contract to the partnership, a contribution judged by the parties to be worth at least $10 million. In PG&E's opinion, the arrangements discussed in these and other documents make it clear that this is a case of contract brokering.

PG&E asserts that the Commission stated that standard offer contracts would be available for well-defined, site-specific projects and should not be used for speculation (D.85-04-075). The adoption of the screening criteria in the QF milestone procedure (D.85-01-038) reinforces this conclusion.

PG&E agrees with Edison that the failure of Edison and complainants to reach an agreement does not amount to bad faith. PG&E cites Friant v. PG&E, D.83-06-109, as stating that the obligation to negotiate in good faith with QFs does not mandate a particular result to the negotiations.

Finally, PG&E asserts that complainants are improperly using the complaint procedure to obtain the Commission's approval of a nonstandard contract.

D. Complainants' Reply

Complainants think that the opposing parties ignore or distort the facts. Complainants believe that the record establishes the following facts:

> "(a) Complainants requested, in a straightforward manner, relocation/assignment of the Unocal Contract; (b) Edison agreed, subject to the resolution of stated concerns and the fulfillment of specified conditions; (c) such concerns were apparently resolved and the required conditions fulfilled; and (d) Edison unilaterally changed its mind in order to insulate itself from any risk and after needlessly committing Complainants to the expenditure of considerable time and resources."

Complainants believe that DRA ignores certain key facts and that Edison and PG&E distort the relevant facts.

On the allegation that complainants seek to engage in contract brokering, complainants make several points.

First, complainants continue to feel that this question is irrelevant to the resolution of their complaint.

Second, complainants point out that brokering suggests an intermediary, who for a commission will bring seller and buyer together. In this case, the parties have remained the same from the outset. Although the precise legal arrangements between the complainants may differ from those that would have been in effect if the project had remained at Brea, the three complainants would have been involved in any event.

Third, Edison's own actions indicate that it had no reservation about the proposed transfer of the project and that it did not believe that there was or should be a blanket prohibition against transfering projects.

Fourth, in a memo of February 26, 1986, from Edison's Bunnell to Nola, it is clear that Edison did not consider complainants' request to be a brokering of the Brea contract:

> "At the time the Brea contract was signed, it appeared that both Unocal (then Union Oil) and Texaco were considering taking a leading role in a coke gasification project. Edison was a participant in a feasibility study conducted with Texaco and Fluor, while Unocal was moving forward on its own.
>
> "However, it seemed common knowledge that only one project would be built. Unocal took the precaution of signing a Standard Offer 4, while the Texaco group only recently made a decision to proceed with contract negotiation. Since Texaco owns the coke gasification technology, they would have been involved in either case, at least as a vendor. This new request probably represents the consolidation of all of the interested parties around one form of the project rather than, as either a move of a project from one location to another, or as one project buying another SO 4 contract and running with it." (Tr. 152.)

Finally, complainants remind DRA and others that any policy the Commission may have against contract brokering is directed against projects that are not in the public interest. Therefore, a threshold question to any analysis involving contract brokering is whether or not the project is in the public interest. Complainants believe that they have demonstrated that the public interest is served by their requested assignment and that, even on its own terms, DRA's objection to its request should be rejected.

Complainants' respond to DRA's concern about the risk for ratepayers by pointing out that fixed price contracts per se are no more risky than a contract that reflects current prices. The real question in complainants' view is whether the certainty of fixed prices is worth the risk that later prices will be lower. Viewed in this way, complainants believe that their requested amendments present no greater risk to ratepayers than a contract based on floating prices.

In connection with this point, complainants state that their calculation of the contract's benefits, which develops long-term costs based on a projection of short-term avoided costs, is the only approved way of developing long-run avoided costs under the Commission's decisions. From the suspension of ISO4 to submission of this case, the Commission had not approved any other method for developing long-run avoided costs.

Complainants reject the allegation that their bad faith claim is based on Edison's failure to agree with them. Complainants assert that their claim is based on Edison's breach of its duty to respond promptly with truthful and timely explanations of its position. Complainants also point out that Edison's claimed counteroffer of the SO2 contract was no counteroffer at all, but merely stated what already existed: the availability of SO2.

Complainants also dispute Edison's claim that its rejection of complainants' proposal was reflected in a memo of February 14, 1986. If that memo is deemed to reflect a rejection of the proposal, then Nola's letter to Commissioner Calvo's office of April 1 must be viewed as reflecting a withdrawal of that rejection. Complainants argue that these documents support their claim that their proposal was not rejected until August 24, 1986.

Edison's claim that the proposal was not well defined is refuted by the many details set forth in the attachment to Unocal's letter of February 19, 1986. Complainants also point out that Edison never conveyed any information to them that suggested that

Edison placed any significance on voltage support or dispatchability. Complainants think that the Commission should give no weight to Edison's position that these issues prevented the parties from reaching an agreement.

E. Edison's Reply

Edison believes that it met the Commission's good faith requirements in its dealings with complainants. It made timely counteroffers and gave explanations. Negotiations were not strung out, as complainants allege, as shown by the fact that all of the negotiations, from the presentation of the proposal in February until Edison's rejection in August, consumed only a total of six months.

Edison also points out that the Commission requires either a counteroffer or an explanation, and thus Edison was not always obliged to explain its position when it presented a counteroffer. The important question, in Edison's view, is whether any explanation was needed at a particular point in the negotiations.

For example, Edison believes that no explanation was required when it exercised its contractual right to terminate the contract. The contract clearly stated the right and required any waiver of this provision to be in writing. Complainants' letter of November 17, 1986, requesting Edison's assurances about the termination issue implicitly acknowledges that only a written waiver would meet the requirements of the contract.

Edison denies complainants' assertion that it encouraged the relocation/assignment or that it waived the requirement for starting construction by the date specified in the contract.

Edison continues to believe that complainants' actions amount to brokering of the contract. Contract brokering is against the Commission's policy, as was made clear in its report to the Legislature on "pioneer" QFs. Edison states, "It would be inconsistent for the Commission to order Edison to perform the very actions it condemns as imprudent to the Legislature."

Moreover, Edison believes that the contract is not in the public interest. The prices in the ISO4 were based on economic forecasts made in May and June 1983 that were declared to be dangerously out of date in April 1985, when the ISO4 was suspended. To grant complainants an opportunity to reinstate such prices would almost certainly result in unnecessary harm to ratepayers.

F. <u>DRA's Reply</u>

DRA's reply clarifies that it takes no position on whether or not Edison has acted in bad faith towards complainants. But DRA continues to believe that the requested relief is not in the public interest. DRA views the proposed assignment and relocation as a means of circumventing the suspension of ISO4, which is equivalent to brokering the contract.

The fixed capacity payments of either the contract or the settlement offer pose an added risk for ratepayers, DRA continues to assert. Such fixed payments are a gamble for ratepayers, regardless of whether they compare favorably or unfavorably with today's outlook of future prices. In addition, such fixed payments provide an undeniable benefit for complainants because they add to the predictability of the project's revenue stream.

DRA adds that even if Edison and complainants had reached agreement on modifying the contract's terms, DRA would have opposed the revised contract as a disservice to ratepayers.

III. <u>Discussion</u>

A. <u>Background</u>

When we chose to develop the standard offers to fulfill in part our obligations under PURPA, one of our hopes was that the existence of the standard offers would avoid the necessity of detailed review of individual contracts between utilities and what promised to be a multitude of QFs. The economic and natural resources of California seemed particularly well suited to the development of the independent generators that PURPA was intended to stimulate, and we concluded that a case-by-case review of individual contracts would soon prove to be unwieldy. Thus, we engaged in the sometimes tedious and laborious task of developing form contracts that the utilities were required to offer to QFs. Once we approved these standard offers, the utility's purchases under the contracts were presumed to be reasonable, and we hoped that this prior approval and presumption of reasonableness would also speed up the review of the reasonableness of the utility's overall purchases.

The standard offers were also designed to neutralize the tremendous bargaining power of the utility as the only purchaser of the QF's power. We adopted several requirements to ease negotiations between utilities and QFs, but the QF's ultimate bargaining power was its right to accept the standard offer if it could not come to different terms with the utility.

Once the QF and the utility signed a contract--either one of the standard offers or a negotiated contract--we had hoped that our subsequent role would be limited to the usual review of the reasonableness of the utility's purchases and administration of its contracts with QFs. If later disputes developed between the utility and the QF about the interpretation or implementation of the contract, we presumed that the parties would turn to the common resources for resolving such disputes--negotiations, arbitration, and, if necessary, the courts.

Complainants have stated their complaint in this case in a way that is apparently intended to fall within the limited role we have said we would assume in these disputes. Nevertheless, it is now clear that the primary points of the complaint boil down to disputes that frequently arise around contracts of all types and that have been addressed in several hundred years of contract law.

Very little in this complaint requires our special expertise to resolve; most of the issues could have been handled by the normal means of dispute resolution.

At this point, having accepted the complaint, conducted the hearings, and evaluated the arguments of the briefs, we will not direct the complainants to another forum. But neither will we ignore the principles that have developed over the years to resolve these issues. Although the parties have to a large part declined to characterize their disputes in terms of contract law, we find that our analysis of these issues is greatly aided by referring to the general principles of the law on contracts and agreements. Our discussion will largely follow this analysis.

B. <u>The Unocal Contract</u>

Our analysis begins with the contract between Unocal and Edison, signed on December 5, 1984. The contract was based on interim ISO4, but there were several terms that differed from the standard offer (see Ex. 14, pp. 4-5, Appendices D and E).

A minor dispute arose during the hearings about whether the contract was or was not an ISO4 contract. It appears that all parties now agree that the contract is a nonstandard contract based on ISO4.

We agree with this characterization of the contract. As a general rule, a contract with only very minor changes from a standard offer might still be regarded as a standard offer. The Unocal contract, however, contained several changes that were bargained over, with each party receiving a concession from the other as part of the agreement to include the changed provisions (Ex. 14, pp. 5-6). When the parties have made mutual concessions to obtain desired changes on substantial terms of the standard offer, the resulting agreement should be viewed as a negotiated or nonstandard contract.

Complainants have argued that the Brea project and the Carson project are essentially the same project. At the time of the signing of the Unocal contract, it is clear from the record that the two projects were proceeding along separate paths. Texaco continued to discuss with Edison the arrangements for a contract to cover its project, and as late as March 1985, the possibility of Edison's participation in the Texaco project was still open (Ex. 14, Appendix F). None of these discussions would have been necessary if the parties had regarded the Brea project and the Los Angeles Coke Gasification Project as the same project. And, as we will discuss, the eventual proposal for the Carson project differed in several important respects from the project described in the Unocal contract.

C. The Proposed Modifications

To accomplish the goal of transfering the Unocal contract to the Carson project, complainants required three separate changes to the Unocal contract. First, the contract had to be assigned to the partnership, and under the terms of the contract this assignment required Edison's consent. Second, several terms of the contract had to be amended to reflect the differences between the Brea project and the Carson project. Edison had to agree to these amendments before the amended contract could be valid. Third, the contract gave Edison the right to terminate the contract if construction had not begun by December 1, 1986. Complainants needed Edison's agreement either to amend this provision or not to enforce its rights under this provision. We will address each of these provisions separately.

1. The Assignment

The Unocal contract specifically provides for assignments in Section 21:

> "Neither Party shall voluntarily assign its rights nor delegate its duties under this Contract, or any part of such rights or duties, without the written consent of the other Party.... Any such assignment or delegation made without such written consent shall be null and void. Consent for assignment shall not be withheld unreasonably."

The contract itself supplies the answers to the issues concerning assignment. Edison's written consent to the assignment was required for a valid assignment. However, Edison had no right to withhold its consent unreasonably. Edison could reasonably inquire about the ability of the partnership to fulfill Unocal's responsibilities under the contract. Once those inquiries were satisfied, however, Edison should have responded to the formal request for assignment of February 19, 1986, with its written consent to the assignment. This record reveals no reason for Edison to have withheld its consent, and we conclude that Edison was bound under the contract to give its written consent to the requested assignment from Unocal to the partnership.

It is important at this point to clarify exactly what such an assignment entailed. An assignment merely replaces one party to a contract with another party. The new party assumes the rights and duties stated in the contract, and those rights and duties are not changed unless the contract is amended. Assigning the contract to the partnership would merely obligate the partnership to build the project at Brea and to sell the required amount of power to Edison at the terms specified in the contract. The assignment would not accomplish the relocation, which required several amendments to the contract, as was recognized in Unocal's request for the assignment.

As things developed, the request for assignment got completely mixed up with the request for relocation. Because the bare assignment of Unocal's rights and duties was virtually meaningless to complainants without the relocation to the Carson site, complainants never pressed the issue of the assignment alone. Edison's failure to grant its written consent to the assignment never really affected the complainants. Thus, we conclude that under these circumstances, Edison's failure to grant its assignment was harmless.

2. The Relocation Amendments

The heart of the complaint concerns Edison's reactions to complainants' request for relocation. In terms of the Unocal contract, the request was for amendments needed to convert the Unocal contract into a valid contract covering the Carson project. Among other terms, the provisions setting forth the size and location of the project needed to be changed. Without these amendments, the mere assignment of the Unocal contract to the partnership would have the effect of obligating the partnership to build and operate the Brea project as described in the original contract.

a. Specific Amendments

Discussions with Edison about a relocation began as early as February 1985, but complainants made their initial written mention of such amendments in the letter of February 19, 1986, from Keith Openshaw, a senior vice president of Unocal, to E. A. Myers, an Edison vice president (Ex.14, Appendix H). However, this letter focuses primarily on the assignment and only briefly mentions the need for amendments. The letter promises a list of needed modifications at a later date.

So far as the record reveals, the detailed list of modifications was never supplied to Edison. Discussions seemed to have turned to the general question whether Edison would consent to a relocation, and the record does not demonstrate that complainants' specific contract amendments were ever communicated to Edison.

If a specific proposal had been presented to Edison, it would have been in complainants' interest to provide evidence of that fact. From complainants' failure to present such evidence, we may conclude that no specific list of proposed amendments was communicated to Edison.

This fact leads to two conclusions. First, we conclude that Edison never expressly accepted the amended contract that complainants desired, because no such offer was ever communicated to Edison. Second, for the same reasons, Edison cannot be found to have negotiated in bad faith concerning specific amendments to the Unocal contract. However Edison's duties in negotiations with QFs are defined, no duties arise unless and until a QF makes an offer or presents a proposal.

These conclusions help us define the issues in this case more clearly. A utility's duties in negotiations with QFs must be evaluated in terms of the specific offer or proposal that the QF presents for the utility's response. The specific proposal that complainants presented to Edison was the request for Edison to consent to the relocation and to agree to negotiate, sometime in the future, specific amendments to the Unocal contract.

b. General Agreement on Relocation

The narrowed question for our resolution thus becomes whether Edison ever agreed in concept to the relocation and agreed to negotiate appropriate amendments to the the Unocal contract.

(1) **Express Agreement**

From our review of the record, it is clear that Edison never expressly consented to the concept of the relocation nor agreed to negotiate appropriate amendments. On all occasions when Edison expressed support for the relocation, it also stated either conditions to its consent that were never fulfilled or proposals for other amendments that complainants never agreed to.

This conclusion may be illustrated by considering the details of one of the times when Edison seemed closest to consenting to the relocation proposal. In March of 1985, Edison had been viewing the relocation favorably, but it withheld its unconditional consent because it wanted to consult with members of the Commission's staff. The staff also seemed to favor the relocation, and Edison sought to confirm the staff's approval in the letter of April 1, 1986, from Sebastian Nola of Edison to

Commissioner Calvo's office. The letter's closing comes close to stating Edison's conditional consent to the relocation:

> "Please let me know if the above remains your understanding, for we plan to proceed with the assignment and relocation based upon your input and suggestions."

The letter seems to say that if staff confirmed the understandings described in the letter, then Edison would consent to the relocation.

Two points, however, prevent us from coming to this conclusion. First, the letter may also be read as soliciting staff's suggestions for Edison's consideration in formulating its ultimate position on the relocation question. Second, and more important, the letter clearly indicates that Edison did not intend at this time to accept complainants' relocation proposal without further negotiations. Perhaps as a result of its earlier discussions with staff, Edison recognized at this time that the California Energy Commission's permit for the project was required, and that the CEC was unlikely to grant that permit unless added dispatchability provisions were included in the contract. For these reasons, the letter states, "Edison will attempt to negotiate dispatchability provisions into this contract."

Our conclusion that no meeting of the minds occurred at this point is confirmed by the notes from a follow-up meeting between Edison and complainants. The notes record that complainants' representatives "indicated general agreement with the terms described in the letter with the exception of the requirement to add dispatch features to the agreement."

Our impression is that this was the point when the parties came closest to agreement. Before this time, Edison made it clear that it wanted to discuss the relocation with the Commission's staff before it would agree to the relocation. Edison's consent in later discussions was conditioned not only on increased dispatchability, but also on adequate approval from a

Commissioner (the approval received was too contingent and ambiguous to supply the assurance Edison desired) and later on a formal order from the Commission, which was never sought.

Thus, Edison never unconditionally accepted complainants' proposal to relocate the project, and complainants never accepted Edison's counterproposals. The meeting of the minds that is the essence of a legally enforceable agreement never occurred.

Another type of express agreement may be formed when a party agrees to perform some act on the occurrence of a stated condition. For example, if Edison had stated that it would agree to the relocation when a formal order was received from the Commission, then it would be bound by its agreement when the stated condition, the Commission's formal approval, occurred. Complainants sometimes seem to suggest that they repeatedly met such conditions, only to be confronted by another condition to Edison's consent to the relocation.

From our review of the record, we can find no instance when Edison stated that it would agree to the relocation if a certain occurrence took place, and then balked on its commitment when the event occurred. It is uncontested that Edison sought various levels of approval from the Commission's staff and from Commissioners, but we can find no clear record that its consent to the relocation was contingent on the receipt of these approvals.

Thus, we cannot conclude from the record before us that a contract was formed upon the satisfaction of a specified condition.

(2) Implied Agreement

The conclusions of the preceding section lead to the next question and to the core of complainants' argument: Should Edison's consent to the relocation and agreement to negotiate amendments to the Unocal contract be implied, either under the doctrines of contract law or under the duties that the Commission has imposed on utilities in their negotiations with QFs?

The law recognizes two types of implied contracts. The first, fully described as an contract implied in fact, arises when the parties' assent to an agreement is manifested by conduct, rather than in words. Nothing in the record in this case suggests that Edison ever consented to complainants' relocation proposal by its conduct, rather than verbally.

The second type of implied contract is the contract implied in law. The law will create an obligation, without regard to the intentions of the parties, when one party receives an benefit which it may not justly retain. A contract implied in law corrects this unjust enrichment and restores the harmed party to its former position. Again, nothing in the facts of this case suggest that any party has been unjustly enriched.

Another legal doctrine that could conceivably apply in this case is promissory estoppel. If, for example, Edison had indicated to complainants that it would consent to the relocation and complainants substantially changed their position in reliance on that representation, Edison's representation would be enforced, even if it received nothing in exchange for its promise, if enforcement was the only way to avoid injustice. But, again, there is nothing in the facts demonstrated in this case that would call for the application of this doctrine.

Thus, we conclude that there is no basis in law for implying that Edison consented to the relocation proposal.

c. Duty to Negotiatiate in Good Faith

The final part of our analysis will consider complainants' assertion that Edison's behavior was a breach of its obligation, created by the Commission, to negotiate in good faith with QFs.

This duty was created in D.82-01-103, when we adopted the standard offer concept and set the ground rules for transactions between utilities and QFs:

> "The utilities are expected and shall be required to bargain conscientiously toward a conclusion. The best evidence of good faith is a collection of written documentation compiled along the way. When the utility is unwilling or unable to accept a QF's proposal, the utility must respond with a timely counteroffer, or an explanation...of:
>
> "1. The specific information needed to evaluate the proposal;
>
> "2. The precise difficulty encountered in evaluating the proposal; and
>
> "3. The estimated date when it will respond to the proposal."
> (D.82-01-103, p. 106.)

Complainants assert vigorously that Edison has breached this duty in its dealings with complainants.

(1) <u>The Nature of the Utility's Duty</u>

A primary problem with complainants' argument is that it ignores the context in which this duty arose. The negotiations referred to in this quotation were the negotiations leading up to a contract between a utility and a QF. At the time of its dealings with complainants, Edison had no reason to believe that the Commission intended these specific obligations to apply to negotiations to modify a contract that had already been sucessfully negotiated.

Thus, our task is to define what obligations towards QFs we should expect Edison to have had during 1986, when its negotiations with complainants took place, in the context of proposed modifications to an existing contract. As a party to a valid and binding contract, Edison had an obligation to deal with the other party fairly and in good faith with respect to contractual matters. Certainly, Edison should have recognized that it had a continuing obligation of good faith in its dealings with complainants as a QF. The specific requirements established in D.82-01-103, however, could not reasonably be expected to apply; since complainants' proposals were never presented in a precise and complete form, it would have been difficult for Edison to have responded within the limits set in D.82-01-103.

The general duty of good faith obligated Edison to respond quickly and frankly to complainants' questions and proposals. However, it must be recognized that the difference between the negotiations toward a contract contemplated in D.82-01-103 and the negotiations toward amendments that are the subject of this case had a significant effect on the nature of the duty of good faith.

The duty created in D.82-01-103 was designed to check, at least in part, the overwhelming bargaining power of a utility that is essentially the only buyer in the market. The specific steps we required from the utility were intended to ensure that the utility would not needlessly delay negotiations and would be honest and fair in making known its legitimate objections to a QF's proposal.

Once a contract is created, however, the positions of the parties change dramatically. The utility, like the QF, has rights and obligations, specifically set forth in the contract. It has promised to perform certain duties, and it has a right, enforceable in court if necessary, to receive the performance promised by the QF. The bargaining imbalance is transformed by the contract into a relationship defined by mutual agreement. In terms of the private law created in the agreement, the parties are equal, and both parties are equally subject to the public law's sanctions for failure to live up to their promises.

These principles help illuminate the proper duty and behavior of Edison when presented with the relocation proposal. At the time the relocation was proposed, Edison had the right to enforce, if it chose, the terms of original Unocal contract (with the possible exception of the changes resulting from an assignment, as previously discussed). Although some of the changes that presumably would be required by complainants' request were minor and had no real effect on the relative positions of the parties, other changes were substantial. For example, to comply with the request for relocation, the contract would have to be amended to reflect the increased size of the relocated project (136 total MW at Brea versus 174 MW at Carson). In addition, because of the change in the thermal requirements of the associated processes, the expected net capacity sales to Edison would increase from 70 MW at the Brea location to 142 MW at Carson (although the amount sold at ISO4 prices would remain at 70 MW).

Edison was correct in viewing this increase as a substantial change in the relative positions of the parties. The primary reason for the suspensions of ISO4 and SO2 was a fear that the capacity payments under these offers were too high in relation to the utility's true avoided costs. This perceived overvaluing was to a large extent a function of the rapid and unanticipated growth in capacity to be supplied by QFs.

Thus, Edison's situation at this time was this: It had an obligation under the Unocal contract to accept no more than 70 MW of capacity at ISO4 prices and 66 MW at SO1, as-available capacity prices. It had received a general proposal to amend the contract to require it to accept additional capacity from the project. The terms under which this capacity would be purchased were somewhat unclear. At a minimum, the relocation would require the purchase of at least 6 additional MW of as-available capacity. The proposal was initially presented, however, as an increase in the contract capacity from 70 MW to 135 MW. This increase was first proposed at the ISO4 prices, although Edison quickly rejected this proposal, since ISO4 had been suspended (Ex. 14, Appendix G).

Later discussions seemed to assume that the additional capacity would be firm capacity, presumably sold at some version of SO2 prices.

How should Edison have responded in these circumstances? At the outset we should note that we have only recently adopted guidelines to govern the utilities' behavior in negotiations of contract modifications with QFs. At the time, obviously, Edison did not have the benefit of these guidelines, and although Edison should have been aware of the guidelines' underlying principles, it would be unfair to apply the specific guidelines retrospectively (D.88-10-032, mimeo., p. 39).

We think it was reasonable for Edison to consider the effect on ratepayers of the substantial modifications that were needed for the relocation. Edison knew at this time that we expected negotiated agreements to be the economic equivalent of our approved standard offers (D.82-01-103, p. 91), and Edison should have made the logical extension of this principle to the results of negotiations to amendments to existing contracts. In evaluating proposed amendments to a contract, Edison should have analyzed both the costs to and benefits for ratepayers that would result from the changes. If, after considering the various aspects of the contract, Edison concluded that the amended contract was no worse for ratepayers than the existing contract, then Edison should have consented to the relocation, assuming that no other concerns superseded this evaluation.

The standard we have just set out is a minimum standard, a threshold test for considering proposed amendments. Certainly it would have been reasonable for Edison to explore the possibility of gaining further benefits for ratepayers from the negotiations, especially in light of our expressed dissatisfaction with the price levels of ISO4. And a corollary of this principle is that if Edison concluded that the net effect of the necessary amendments was detrimental to ratepayers, it should have attempted to receive roughly equivalent concessions to maintain the ratepayers' economic indifference to the changes in the contract.

Edison alleges that its attempts to negotiate improved provisions on dispatchability and reactive power support were motivated by this consideration. Complainants view the reference to dispatchability and reactive power support as a red herring, fished out after the fact to divert attention from Edison's bad faith.

The record indicates that the issues of dispatchability and reactive power support were raised repeatedly throughout the negotiations. The notion of including increased dispatchability was first raised in the preliminary negotiations of February 14, 1986 (Ex. 14, Appendix G). Unocal's written request for relocation of February 19 (Ex. 3, Ex. A; Ex. 14, Appendix H) included a discussion of dispatchability and reactive power support and indicated that complainants were willing to negotiate appropriate modifications with Edison. The April 1, 1986, letter also stated that Edison would attempt to negotiate improved dispatchability provisions into the amended contract (Ex. 14, Appendix I). By April 18, 1986, complainants were unwilling to increase dispatchability, but the issue seemed to remain part of the negotiations (Ex. 14, Appendix J). The issue of dispatchability surfaced again in the meeting of September 25. Even as Edison rejected complainants' request for the relocation and assignment, it included dispatchability as a desirable element of a new contract (Ex. 14, Appendix N). And the final negotiations between the parties centered on the issue of dispatchability (Ex. 14, Appendix O).

We conclude that the issue of increased dispatchability was not a diversion but was a central element throughout the negotiations between the parties. We also conclude that improved dispatchability was a logical and reasonable concession for Edison to seek in exchange for accepting additional firm capacity from the project. The value of capacity varies throughout the day and with the seasons. Increased dispatchability meant that Edison could use the capacity it was obliged to purchase at those times when it would be most valuable to Edison's system, thus minimizing any overpayments that would result from changes in forecasts of the value of capacity.

(2) <u>Consideration of the Project's Benefits</u>

Complainants respond that Edison should have also considered the additional benefits associated with the relocated project in reaching its decision on the relocation request.

As we have discussed, we agree with the general principle that the utility's evaluation of proposed amendments should consider both the costs and benefits for ratepayers of the proposed amendments. Complainants urge that the benefits of their proposed contract to a broader group than just ratepayers should be considered.

Complainants' list of benefits of the Carson project include the demonstration of new technologies with environmental benefits, direct benefits to Edison's ratepayers, the reduction of environmental pollutants, reduction of dependence on imported oil, increased load-following abilities, reduction in transmission losses, and indirect benefits to Edison's ratepayers and other Californians in the form of reduced oil imports, increased in-state oil refining, and increased employment.

Complainants' list of benefits raises several issues. First, in D.82-01-103 we considered how to regard societal benefits in the calculation of avoided cost:

> "These 'social costs' include the risks associated with imported energy supplies and environmental degradation related to conventional generation. While several parties suggested that we explicitly include 'social costs' in the avoided cost calculation, we are not including such factors at this time. We prefer to recognize social costs in the general

> policy judgment that QF production is competitive at avoided costs." (D.82-01-103, pp. 25-26.)

Translated into the terms of this case, these principles mean that larger social benefits do not in themselves justify the payment of higher prices to the QF, as complainants recognize. It is clear that the Carson project has tremendous potential to demonstrate some enormously beneficial technologies, and we believe that the record shows that Edison recognized these benefits from the outset. However, the question of how much ratepayers must pay to support those benefits had to dominate Edison's consideration of the relocation.

Another aspect of complainants' argument is an analysis of the direct economic benefits to ratepayers. A large part of this analysis considers the effect of a settlement offer that complainants made to Edison on May 26, 1987. However, the evaluation of Edison's good faith in negotiating with complainants requires us to consider only the information that was available to Edison at the time of the alleged bad faith. The settlement offer, which we will later discuss in detail, was not conveyed to Edison until well after the period of the direct negotiations.

Thus, the analysis of direct economic benefits that Edison should have performed in response to Unocal's request should compare the Unocal contract with the contract that complainants were seeking in their relocation request. This comparison, as performed by complainants' witness, resulted in net costs ranging from $80 million to $194 million for ratepayers under the four scenarios considered. Although Edison did not apparently perform such a detailed analysis, the record is clear that Edison was concerned about the cost of the proposed modifications from the beginning of negotiations.

The indirect benefits listed by complainants also present at least two problems. First, many of the listed benefits flow to a broader segment of society than just Edison's ratepayers, although the relevant costs of producing these benefits is borne only by Edison's ratepayers. For example, reduction of environmental air pollution will benefit the customers of the Los Angeles Department of Water and Power, other municipal utilities, and possibly San Diego Gas & Electric Company, but those customers will bear none of the costs. Reduction of oil imports and stimulation of in-state oil refining benefits an even more diffused group, but the costs remain concentrated on Edison's customers. We do not require or expect costs and benefits to match perfectly in all instances, but fairness requires that a substantial benefit should accrue directly to those who bear the costs. It is difficult to give much weight to complainants' arguments on indirect benefits when the benefits are so attenuated and the costs are so concentrated.

A second problem with the consideration of indirect benefits is the mismatch between costs and benefits even within the class of Edison's ratepayers. A large industrial customer may use relatively little electricity but consume large quantities of imported oil; this customer will benefit from the reduction of oil imports but pay little of the cost. A residential customer who does not own a car may consume proportionally large amounts of electricity in relation to oil use; this customer will receive little benefit for the extra costs. These are extreme examples, but they illustrate the difficulties of evaluating indirect benefits.

In reviewing the record of Edison's behavior during negotiations with complainants, we conclude that Edison properly focused primarily on the direct costs to ratepayers of the proposed amendments, while it recognized and gave weight to the particular benefits that this project promises.

d. Conclusion

We conclude that Edison acted reasonably in attempting to gain concessions in the form of improved dispatchability and reactive power provisions in exchange for agreeing to the relocation. There is no evidence that these attempts were maintained unreasonably, in bad faith, or merely to prolong the negotiations. We also conclude that complainants never agreed to Edison's proposal.

We have also found that Edison never expressly or impliedly agreed to the general relocation proposal or to negotiate specific amendments to the contract.

We have concluded that Edison met the standard of good faith that it could reasonably have believed applied to its behavior during negotiations of this sort.

Our ultimate conclusion is that complainants are not entitled to the central element of their request, an order to Edison to consent to the relocation of the project from Brea to Carson.

3. The Construction Start-up Date

The final element of the proposed modifications is the extension of the construction start-up date set in the Unocal contract. Section 3.3 of the contract gave Edison a right to terminate the contract if construction had not begun by December 1, 1986 (Ex. 16, pp. 11-12). Edison exercised its right under the contract to terminate the contract, an act that quickly led to this complaint.

Complainants argue that part of Edison's bad faith is shown by its statements about its intentions with regard to its right to terminate. Complainants assert that the issue of the termination was raised by Texaco in preliminary discussions with Edison as early as July and August 1985. Complainants also contend that the subject came up during meetings with Edison on February 12 and 13, 1986, and that Edison's representatives said that the construction start-up date would not be enforced. This discussion does not appear, however, in Edison's memorandum summarizing the meeting. No further communications about this provision are reflected in the record until December 1, 1986, when Edison sent its formal notice of intent to terminate.

The evidence on this point is skimpy. The testimony concerning Edison's statement that it would not enforce the construction start-up date was not contradicted. We also deduce from the silence of the record on discussions during the intervening months that complainants had some basis for believing that the termination provision would not be exercised. We note that the parties were still discussing a possible new agreement as late as October 24, 1986, without mention of the construction deadline.

We conclude that Edison represented to complainants in February 1986 that it would not exercise its contractual right to terminate the contract if the construction start-up date was not met. Even if Edison received nothing in exchange for its promise, complainants reasonably relied on the Edison's promise and delayed beginning work on the project in reliance on Edison's representation. Under such circumstances, the law will enforce the promise under the doctrine of promissory estoppel. We believe that the circumstances in this case compel a similar result, and we conclude that Edison should be held to its promise not to enforce the construction start-up date.

However, we do not find the necessary support for complainants' requested finding that Edison's exercise of its termination rights constituted bad faith. As we have discussed, Edison retained all the rights that Unocal had agreed to give Edison under the original contract, including the termination provision, unless and until the contract was amended. It is

Edison's representation that it would not exercise its termination rights that persuades us that the termination should not be enforced.

D. The Settlement

After the complaint was filed, the parties attempted to negotiate a settlement of the case. On May 26, 1987, Unocal presented a settlement offer that substantially changed its proposal for amending the Unocal contract. Edison did not accept the proposed settlement, and the case proceeded to hearing. At the hearing, Unocal presented the terms of the settlement offer as the basis for a contract it would accept if the Commission is inclined to grant it relief but is unwilling to reinstate the original contract.

We take Unocal's tender of the settlement offer as a realistic acknowledgement of the changes that have occurred since the prices of ISO4 were developed in May and June of 1983. However, we do not believe that our decision in this case should be swayed by the presence of the settlement offer; if Unocal is entitled to the requested relocation and assignment, the other original contract terms agreed to by the parties should be enforced. If Unocal is not entitled to the relocation and assignment, then the existence of a more attractive offer is irrelevant to our resolution of this complaint.

Throughout this opinion, we have stressed that standard offers, once accepted, are contracts between the QF and the utility and are subject to the same laws and principles as other commercial contracts. Any modifications to the contract should be negotiated and agreed to between the parties. In this case, the parties attempted to negotiate a settlement to the complaint, but those efforts were ultimately unsuccessful. While we do not believe that Unocal was attempting to negotiate with the Commission rather than Edison, introducing an offer that was not accepted by the other party to the contract could be perceived as interjecting the

Commission into the contractual relations between the parties. We want to discourage this perception and to discourage other parties from trying to involve the Commission in contractual disputes. In this case, we think the settlement offer should be disregarded for purposes of our decision.

Our action should not be seen as discouraging settlements; we favor settlements and have set up procedures for our consideration and approval of settlements. But before a settlement is brought before us, it should be agreed to by at least some of the concerned parties. We encourage Unocal and Edison to continue to attempt to negotiate an arrangement that would permit the beneficial technologies to be demonstrated without undue cost to ratepayers.

IV. Conclusion

We have found that Edison should have responded promptly and favorably to complainants' written request for assignment of the contract and that Edison violated its earlier promise not to enforce its right to terminate the Unocal contract if construction was not started by December 1, 1986.

On the central point of the complainants' requested relief, however, we have concluded that Edison never expressly or impliedly agreed to the relocation or to negotiate appropriate amendments to the Unocal contract that would permit the relocation of the project from Brea to Carson. We have also concluded that Edison did not breach the duties imposed by the contract or by this Commission in its negotiations with complainants about the relocation. In light of the central importance of the relocation to complainants' requested relief, our conclusions that Edison did not act properly concerning the assignment and the termination appear to have no real significance.

Under the circumstances, complainants' requested relief is not justified, and the complaint should be denied. However, we wish to stress again that we think the project is a promising one and, in the spirit of our policy favoring reasonable settlements of disputes, we would like to point out an alternative which these two parties may want to evaluate. The most attractive approach may be to start afresh with a new contract under final SO 4 or the reinstated SO 2, both of which will be under consideration in our resource plan proceeding to commence shortly. We note that in a recent decision (D.88-12-032) we offered that a settlement with such terms would leave ratepayers indifferent and yet maintain the viability of what we consider a promising technology.

In their comments on the proposed decision, complainants argue that the doctrine of promissory estoppel should apply to extend the firm operation date requirement of the contract. We have applied this doctrine to prevent enforcement of Edison's right under Section 3.3 to terminate the contract when construction did not start by December 1, 1986. Termination for failure to achieve firm operation within five years of the execution of the contract, or by December 5, 1989, however, is governed by a separate provision, Section 12.

According to the record in this case, complainants focused almost entirely on obtaining an extension of the first deadline they had to meet, the time for beginning construction. It appears that the question of extending the five-year limit for firm operation was not raised until November 1986. From our review, we find nothing in the record that suggests that Edison made any representations or promises not to terminate the contract if the project did not meet the required firm operation date. This sort of promise or representation is an essential element of the doctrine of promissory estoppel, and without such a promise we cannot use this doctrine to overcome the plain language of the contract.

We will not order the extension complainants request, but we encourage the parties to come to a reasonable accommodation on the firm operation date as part of their attempts to find a way to allow the construction and operation of this project to proceed under new standard offers that might become available in the future. In this way the interests of the project developers and ratepayers are equitably balanced.

Findings of Fact

1. Edison and Unocal entered into a contract based on ISO4 on December 5, 1984. The contract concerned the sale of 70 MW from a coke-fired cogeneration facility at Unocal's ammonia plant in Brea.

2. On February 19, 1986, Unocal asked Edison to assign the contract to a partnership consisting primarily of Unocal, Texaco, and Fluor.

3. The contract stated that Edison could terminate the contract if construction on the gasification facility and project did not begin by December 1, 1986.

4. On December 1, 1986, Edison notified Unocal of its intent to terminate the contract.

5. The Unocal contract contained several terms that differed from ISO4. The parties bargained about these terms and made mutual concessions in arriving at the agreement.

6. Negotiations over the Los Angeles Coke Gasification Project, with Texaco as the leading sponsor, continued after the Unocal contract was signed.

7. In its letter to Edison of February 19, 1986, Unocal stated that it would supply Edison with a list of amendments that were needed to have the Unocal contract apply to the relocated project at Carson.

8. Complainants did not supply Edison with a list of requested amendments to the contract to accomplish the requested relocation of the project.

9. The most specific proposal that complainants presented to Edison was a request for Edison to consent to the relocation of the project from Brea to Carson and to agree to negotiate, sometime in the future, specific amendments to the Unocal contract.

10. Edison presented complainants with counterproposals concerning dispatchability and voltage support.

11. At the time it was considering the relocation request, Edison had a contractual right to require Unocal to perform its obligations under the Unocal contract.

12. The proposed relocation would have resulted in a substantial change in the relative positions of the parties to the Unocal contract.

13. Edison raised the issue of dispatchability on or about February 14, April 1, April 18, and September 25, 1986.

14. The Brea and Carson projects would provide a demonstration of beneficial technologies and would result in other benefits, including reduction of environmental pollutants, reduced dependency on imported oil, and increased employment.

15. Many of the benefits associated with the Brea and Carson projects would not accrue directly to Edison's ratepayers, although the costs of the projects would be primarily borne by Edison's ratepayers.

16. A comparison of the direct costs and benefits to Edison's ratepayers of the Carson project concludes that ratepayers would incur net costs ranging from $80 million to $194 million.

17. Edison represented to complainants in February 1986 that it would not enforce its right to terminate the Unocal contract if the start of construction was delayed beyond December 1, 1986.

18. Complainants reasonably relied on Edison's representation and did not take steps to begin construction by December 1, 1986.

19. Complainants presented a settlement offer to Edison on May 23, 1987.

20. Edison has not accepted complainants' settlement offer.

<u>Conclusions of Law</u>

1. The Unocal contract is a negotiated or nonstandard contract.

2. The Brea project and the Los Angeles Coke Gasification Project were not the same project.

3. Edison should have consented to the assignment of the Unocal contract to the partnership.

4. Edison did not accept an amended contract to allow relocation of the project, and complainants did not offer such an amended contract to Edison.

5. Edison did not negotiate in bad faith concerning specific amendments to the Unocal contract.

6. Edison did not expresssly consent to the concept of relocating the project nor to negotiate specific amendments to the contract to permit relocation.

7. Complainants did not agree to Edison's counterproposals on dispatchability and voltage support.

8. No ground exists for finding that Edison impliedly agreed to complainants' relocation proposal.

9. In evaluating the relocation request, it was reasonable for Edison to consider the effect on ratepayers of the substantial changes to the contract that were needed to accommodate the relocation.

10. Edison did not act in bad faith in considering the request for relocation.

11. Edison should be held to its promise not to enforce its right to terminate the Unocal contract if construction did not begin by December 1, 1986.

12. The relocation is the central element of the complaint.

O R D E R

IT IS ORDERED that the complaint of Union Oil Company of California, Texaco Syngas, Inc. and Fluor Carson Inc. is denied.

This order becomes effective 30 days from today.

Dated MAR 8 1989, at San Francisco, California.

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

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

Victor Weisser, Executive Director

ALJ/BTC/ltq

Decision ____________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

UNION OIL COMPANY of CALIFORNIA, a California Corporation; TEXACO SYNGAS, INC., a Delaware Corporation; and FLUOR CARSON, INC., a California Corporation, Complainants, vs. SOUTHERN CALIFORNIA EDISON COMPANY, Defendant.	Case 87-01-023 (Filed January 14, 1987)

Messrs. Armour, St. John, Wilcox, Goodin & Schlotz, by James D. Squeri, Attorney at Law, for Union Oil Company of California, Texaco Syngas, Inc., and Fluor Carson, Inc., and Joseph P. Foley, Attorney at Law, for Texaco, Inc., complainants.

Richard K. Durant, Carol B. Henningson, and Julie A. Miller, Attorneys at Law, for Southern California Edison Company, defendant.

Howard V. Golub, Michael S. Hindus, and Jo Shaffer, Attorneys at Law, for Pacific Gas and Electric Company, interested party.

Thomas W. Thompson, for the Division of Ratepayer Advocates.

OPINION

I. Background

Union Oil Company of California (Unocal), Texaco Syngas, Inc. (Texaco), and Fluor Carson, Inc. (Fluor) (collectively referred to as complainants) filed a complaint against Southern California Edison Company (Edison) on January 14, 1987.

The general factual background to the complaint began in 1983 and grew out of the interest of Unocal, Texaco, and Fluor in developing a project to convert petroleum coke to electric power. Petroleum coke is a byproduct of crude oil refining. Texaco had developed a process for gasifying the coke. The gas could fuel cogeneration units, and hydrogen could be produced out of this entire process.

In 1984, Unocal and Edison executed a contract based on interim Standard Offer No. 4 (ISO4) for the sale of 70 MW from a coke-fired cogeneration facility at Unocal's ammonia plant in Brea. The federal Public Utility Regulatory Policies Act of 1978 (PURPA) requires utilities to purchase electricity produced by certain qualifying facilities (QFs), including cogeneration facilities, at the utility's avoided cost, or the costs the utility avoids by purchasing power rather than generating an equivalent amount of power from its own system. The standard offers, with terms and prices that we had found reasonable, are one of our efforts to comply with our responsibilities under PURPA. ISO4 provides a long-term certainty of price for QFs willing to enter into a long-term contract with the utility. Because the price of power purchased under ISO4 contracts available at this time was based on projections made in May and June of 1983, these contracts were particularly desirable when short-term avoided costs declined in parallel with falling oil prices and with an unexpected increase in the electric capacity available to utilities. We suspended the availability of ISO4 on April 17, 1985 (Decision (D.) 85-04-075).

After the contract was signed, local opposition in Brea led Unocal to consider pursuing the project elsewhere. It began to explore with Edison the possibility of relocating the project to Carson and assigning the contract to a new partnership consisting primarily of complainants.

Discussions with Edison continued for a while, but in September 1986 Edison informed Unocal that it would not consent to the assignment and relocation without a formal order from the Commission. When construction had not begun by the start-up date established in the contract, December 1, 1986, Edison exercised its contractual rights and terminated the contract.

The complaint concerns Edison's refusal: (1) to execute and consent to the assignment of the contract between Unocal and Edison to the new partnership; (2) to consent to an amendment of the contract to permit relocation of the underlying project from Brea to Carson; and (3) to extend the construction start-up date specified in the contract. The complaint asks the Commission to order Edison to execute the assignment of the contract, consent to the relocation, and extend, on a reasonable basis, the contract's construction start-up date.

Edison answered the complaint on February 26, 1987. In addition to the expected denials of complainants' allegations, Edison views the contract as a nonstandard, negotiated agreement with Unocal, rather than an ISO4. Edison affirmatively argues that the Brea project and the Carson project were two different projects, and that the Commission's decisions required Edison to obtain concessions in exchange for substantial changes in the contract in order to maintain ratepayer indifference. Edison denies that it negotiated in bad faith with complainants concerning the assignment and relocation. Edison further alleges that the complaint seeks relief--essentially an order to Edison to execute a nonstandard contract--that the Commission had previously stated it would not grant. Several defenses based in contract law are also raised. According to Edison, the requested relief would be inconsistent with the suspension of ISO4. Finally, Edison argues that permitting site switching and brokering of the contracts with QFs would create an undesirable precedent.

Complainants felt it necessary to file a reply to Edison's answer on March 18, 1987. The reply primarily addressed Edison's affirmative defenses.

A prehearing conference was held on May 5, 1987, and evidentiary hearings were held on September 24 and 25, 1987. Pacific Gas and Electric Company (PG&E) and the Commission's Division of Ratepayer Advocates (DRA) intervened in the proceeding and participated in the hearings.

II. Positions of the Parties

A. Complainants' Position

Complainants first note that D.82-01-103 and D.83-10-093 imposed on utilities a duty to negotiate in good faith with QFs. Complainants believe that Edison breached its duty by repeatedly leading complainants to believe that Edison would consent to the requested assignment and relocation if complainants would comply with a specific Edison request. But each time complainants complied with a request, Edison posed additional conditions to its consent, culminating in Edison's September 1986 statement that it would not agree to the assignment and relocation without a formal order from the Commission, according to complainants. Complainants relied on Edison's apparent willingness to consent to the assignment and relocation, but eventually time ran out and the project was delayed until meeting the construction start-up date set in the contract was impossible. Edison promptly exercised its right of termination when the target construction start-up date passed.

Complainants believe that Edison misinterpreted the Commission's policies and that its insistence on insulation from any possible risk connected with the relocation was a further breach of its obligations.

Complainants reject Edison's attempts to characterize the issues in this case as involving contract brokering or site switching. According to complainants, a properly framed statement of the issues the Commission must resolve in this case is:

"(1) Is the proposed Carson Cogeneration Project as well as the terms and conditions under which power sold from such a project would be sold to Edison in the interest of Edison's ratepayers?

"(2) Given repeated representations by Edison that assignment/relocation of the Unocal Contract was appropriate, should Edison be required to execute a power purchase agreement consistent with Complainants' May 26 settlement offer?"

1. <u>The Project's Benefits</u>

Complainants answer their first question by listing the benefits that the Carson project will provide to Edison's ratepayers and other Californians.

First, the project will demonstrate several unique technologies: conversion of waste petroleum coke to clean-burning fuel gas; coproduction of hydrogen for upgrading heavy California crude oils to clean transportation fuels; coproduction of methanol for transportation fuels, clean-burning boiler fuels, and load following of combustion turbines; air pollution control technology that exceeds the current state of the art; and the capability to destroy completely waste oils and water effluents from refineries.

Second, the project will provide direct economic benefits to Edison's ratepayers. For this analysis, complainants have used the terms of a settlement they offered to Edison on May 26, 1987. Although complainants believe that they are legally entitled to assignment and relocation of the original Unocal contract, they have reduced their claim in the settlement offer because they believe that they may expect affirmative action from the Commission only if the project is found to advance the public interest and because ambiguities create different interpretations of the contract.

The original contract contained the following terms: 70 MW of firm capacity at $179 per kilowatt-year (kW-yr); 66 MW of as-available capacity; and energy associated with 136 MW at 9.8 cents per kilowatt-hour (kWh). The settlement offer contained the following terms: 70 MW of firm capacity based on $179 per kW-yr, escalated to $224 per kW-yr to account for delaying the firm operation date from 1989 to 1992; 66 MW of firm capacity at $103 per kW-yr; energy associated with 70 MW at 9.8 cents per kWh; and energy associated with 66 MW at 6.4 cents per kWh. Complainants' economic analyses are based on the latter terms.

Complainants have developed two analyses of short-run avoided costs, one based on Edison's projections of fossil fuel costs and the other based on projections of fossil fuel costs made by the California Energy Commission (CEC). Complainants also compared the costs and benefits of the settlement offer's 1992 firm operation date with the 1989 firm operation date of the original contract. Complainants believe that this comparison properly represents the ratepayers' perspective on this controversy.

This analysis shows that benefits ranging from $16.1 million to $57.7 million result when the settlement offer's terms are compared to the CEC's fuel price projections, and expected losses ranging from $24.2 million to $54.3 million result when Edison's projections are used. Complainants argue that viewing these results as best and worst cases, or using the midpoint of the ranges, results in estimates that, standing in isolation, are acceptable from the ratepayers' viewpoint.

Complainants think that consideration of other benefits swings the analysis in favor of their requested relief. The project provides insurance against higher oil prices. The success of the project will stimulate similar projects, which will provide a competitive alternate energy source tending to limit future oil price increases. In addition, the project will reduce emissions of oxides of nitrogen (NOx) in the Los Angeles basin; will allow fuel cost savings from burning methanol in Edison's combustion turbines or from overfiring in thermal plants; will result in reduction of off-peak power purchases due to load following using the methanol flywheel; and will reduce transmission losses because of the project's location near Edison's load center.

Complainants estimate the savings from NOx reductions and fuel cost savings to be $15 million and $45 million, respectively. No estimates have been made of the savings in off-peak purchases and transmission losses because of insufficient data.

Complainants conclude that the direct benefits to Edison's ratepayers justify granting the requested relief.

The project will also provide substantial indirect benefits to ratepayers and to other Californians, complainants say. For example, the project's success will stimulate additional projects with similar benefits. Complainants estimate the benefits of these subsequent projects for ratepayers to range from $80 to $310 million. Thus, complainants assert, the direct and indirect benefits to Edison's ratepayers total $95 million to $355 million.

Complainants also believe that the project will benefit Californians in general. First, the project will reduce oil imports and increase the in-state refining of California crude oil. Coke gasification also increases the proportion of heavy crude that can be converted to clean transportation fuels. The hydrogen that is a coproduct of the project is needed in large quantities to refine heavy crudes into unleaded gasoline, low sulfur diesel fuels, and jet fuels. Second, the project will demonstrate an alternative to natural gas as a domestic source for production of methanol. Third, the project will demonstrate an electric generation technology that exceeds current air pollution control standards. Fourth, the project will increase the state and local taxes by $25 million and increase employment by 800-1000 person-years during construction and by 90-100 permanent jobs.

Complainants acknowledge that such external benefits do not independently justify their requested relief, but they argue that such benefits should be considered by the Commission in reaching its decision in this case.

2. <u>Edison's Conduct</u>

The second prong of complainants' argument is that Edison's conduct and representations to complainants justify granting their requested relief. Complainants argue that they expended substantial time, effort, and money based on Edison's continued representations that complainants' efforts were entirely consistent with Edison's interests. Complainants believe that an examination of Edison's conduct leads to the conclusion that complainants are entitled to the requested relief.

Unocal began studying the feasibility of a coke gasification facility at its Brea plant in July 1983. In 1984, Fluor and Texaco began providing their services to the project. In 1984, Fluor, Texaco, and Edison formed a joint venture to study construction of a coke gasification project, called the Los Angeles Basin Coke Gasification Project. Many sites were evaluated, and in August 1984 the venture began to identify specific customers for the products of the project.

Unocal executed the power purchase agreement with Edison for the Brea project in December 1984. Execution of the contract stimulated local opposition to the project, and Unocal determined that relocation to the Los Angeles harbor area, where there is a concentration of coke production, would be preferable to remaining at the Brea site.

In February 1985, Unocal initiated discussions with Edison about the transfer of the Unocal contract to another site. At that time, Edison said it had no policy on such transfers. In March 1985, Edison withdrew from the L.A. Basin Coke Gasification Project, but expressed an interest in rejoining the project when it was more developed. Fluor and Texaco continued development of the project.

At about the same time, Unocal, Texaco, and Fluor began discussions about jointly pursuing a coke gasification project, and these parties have worked together on the project since that time. Although no executed written agreements have formalized the joint arrangement, collateral agreements and the expenditure of tens of millions of dollars demonstrate a continuing and substantial commitment among the complainants to develop the Carson project.

Meanwhile, according to complainants, Edison was encouraging complainants to relocate the project. On June 26, 1985, one of Edison's senior managers advised Texaco that the Unocal contract could be relocated and that the Unocal contract was one of the few contracts that had such flexibility. In August 1985, Texaco initiated discussions with Edison concerning the assignment of the Unocal contract to the Unocal-Texaco-Fluor partnership, relocation of the project from Brea to Carson, and extension of the construction start-up date contained in the contract. Edison indicated that the construction start-up date would not be enforced as long as the deadline for the start of firm operation could be met and that the contract could be assigned to the partnership, complainants contend.

Negotiations on these topics continued. In meetings on February 12 and 13, 1986, the partnership again raised the problem of the construction start-up date, which at this time clearly could not be met because of continuing negotiations. According to complainants, Edison again stated that the construction start-up date would not be enforced.

On February 19, 1986, Unocal formally requested Edison's consent to assignment of the contract to the partnership and to relocation of the project to Carson. On March 6, Edison stated that it favored approving the assignment, but it reserved its final opinion until it had consulted the Commission's staff. Edison met with staff members on March 6. On April 1, Edison told the Commission's staff that it intended to proceed with the assignment and relocation, provided that the staff's representations made at the March 6 meeting remained in effect. The staff conveyed the required assurances to Edison, according to complainants.

Despite these assurances, Edison refused to execute the amendment to the contract to permit the assignment and relocation. Edison now required the approval of a Commissioner before it would consent to the assignment and relocation. On May 16, Edison met with Unocal and Texaco and approved the correspondence that would request the Commissioner's review and approval of the assignment and relocation. On July 17, Unocal submitted the request to Commissioner Calvo. Commissioner Calvo responded on July 29, with a letter stating that the assignment and relocation was consistent with the Commission's policies and was not unreasonable in light of the facts stated in the request.

On August 24, 1986, Edison informed Unocal that it would not consent to the assignment and relocation based on Commissioner Calvo's letter. On September 26, Edison told Unocal that it required a formal Commission order ratifying the reasonableness of Edison's consent before it would agree to the assignment and relocation.

Complainants argue that Edison misled them at every point until the statement in August that it would not consent to the assignment and relocation. Edison's argument that the terms of complainants' request were unclear or that the terms changed over time is belied by the April 1 correspondence from Edison to Commissioner Calvo's office, which accurately described the proposal in detail.

Complainants believe that the preceding facts compel rejection of Edison's arguments that it knew all along that the assignment and relocation was not in the ratepayers' interest; that Edison never entertained the possibility that it would voluntarily agree to the assignment and relocation; that Edison intended strictly to enforce the terms of the Unocal contract; and that Nola's April 1 correspondence represented only the opinion of an individual who had no authority to bind Edison.

Thus, complainants argue, Edison intended all along to terminate the contract, and Edison negotiated in bad faith by misrepresenting its intentions to complainants. At best, "Edison utterly failed to communicate its intentions to Complainants and negligently led Complainants down the path of meaningless and fruitless negotiations."

Because the Carson project is in the public interest and in light of Edison's conduct, complainants ask the Commission to order Edison to execute a power purchase agreement based on the settlement offer of May 26.

B. Edison's Position

In Edison's view, this case involves two separate projects, the Unocal Brea project and the Texaco/Fluor project. The Texaco/Fluor project was not sufficiently defined to allow an ISO4 contract to be signed before the Commission suspended ISO4 on April 17, 1985. The request for the assignment of the Unocal contract first came after the suspension of ISO4.

Edison negotiated with the complainants to develop a contract that was in the ratepayers' interest. When these efforts proved unsuccessful, however, it notified complainants that it would not agree to assign the Unocal contract without obtaining further benefits for ratepayers. When the start-up date called for in the contract passed without the start of construction, Edison exercised its contractual right to terminate the agreement.

Edison believes that this case presents a clear test of the Commission's policy on contract brokering and site switching.

1. Factual Background

Edison's view of the facts of this case differ from complainants' in several key respects.

First, Edison views the Unocal contract as a nonstandard contract, since Unocal requested and obtained several changes from the standard offer. Edison believes the contract was for a 136 MW cogeneration project, with 70 MW of firm capacity and associated energy to be sold to Edison and the remaining 66 MW to be used on site.

The Texaco/Fluor venture was an entirely separate project, in Edison's opinion, that did not mature fast enough to qualify for an ISO4 contract before the suspension. After the suspension, Edison informed Texaco and Fluor that any further negotiations would have to be based on the terms of Standard Offer No. 2 (SO2), which remained in effect. The proposal to assign the Unocal contract followed.

Edison negotiated with the complainants, in hopes of incorporating dispatchability and voltage support in the contract. By August 1986, Edison became convinced that the operating characteristics of the Carson project would not permit dispatch. At the same time, falling energy and capacity price forecasts convinced Edison that the project would not provide economic benefits to Edison's ratepayers. Edison informed the partnership of its conclusion at the August and September meetings.

Edison did not regard the letter from Commissioner Calvo as providing sufficient assurance to justify the assignment and relocation. Although the letter generally supported the project, key language on the reasonableness of Edison's proposed action was vague.

Because of the lack of ratepayer benefits, Edison would not consent to the assignment and relocation of the project, even today, without a direct order from the Commission.

2. **Edison's View of the Issues**

Edison also differs with complainants in its view of how the issues in this case should be defined. Edison believes that in order to grant the requested relief, the Commission must agree with complainants that Edison negotiated in bad faith and that the appropriate equitable remedy is to assign the Unocal contract to the Carson project. Moreover, Edison argues that the Commission need not reach the issue of bad faith if it finds that the proposal is not in the ratepayers' interest or that the requested relief is inappropriate. Edison believes that granting the requested relief would create a very bad precedent for future transactions with other QFs.

3. <u>Edison's Conduct</u>

Edison says that it did not negotiate in bad faith. The duty to negotiate in good faith with QFs was created in D.82-01-103. The nature of this duty was stated very clearly:

> "When the utility is unwilling or unable to accept a QF's proposal, the utility must respond with a timely counteroffer, or an explanation...of:
>
> "1. The specific information needed to evaluate the proposal;
>
> "2. The precise difficulty encountered in evaluating the proposal; and
>
> "3. The estimated date when it will respond to the proposal." (D.82-01-103, 8 CPUC 2d 20, 85.)

Edison believes it has met this duty. For example, Edison explained why it was refusing the partnership's proposed amendments, as detailed in the testimony of its witness John Bunnell, and it made a counteroffer based on SO2. Edison believes that complainants are trying to assert that investigating a proposal and attempting to work out a solution is bad faith if a solution cannot be reached. In essence, complainants' thesis is that the utility cannot break off preliminary negotiations. Case law and the relevant literature have rejected this notion.

Edison also rejects complainants' assertions that they had met all conditions that Edison had established for its consent to the assignment and relocation. Several important elements of Edison's negotiating package--dispatchability, voltage support, and other operating benefits--were never agreed to by complainants. Edison did not finally reject complainants' proposal until it became clear that complainants were not willing to include these important benefits for ratepayers in the amendments.

Moreover, Unocal should have been aware all along that it bore the risk that the project would not be developed, Edison argues. The contract clearly gave Edison the right to terminate if the construction start-up date was not met, and the contract also required a waiver of any of the contract's provisions to be in writing. The contract clearly placed the risk that the project would not go forward on Unocal.

4. <u>The Requested Relief</u>

Edison also argues that the relief requested by complainants is inequitable and inappropriate.

The relief is procedurally inappropriate because complainants' request, in essence, is an application for review of a nonstandard contract. The Commission has ruled that only the utility may file for review of a nonstandard contract. Furthermore, the Commission has ruled that it does not intend to intervene in or rewrite contracts, which is precisely the relief that complainants request.

In addition, the terms of the requested relief are in dispute. Edison believes that complainants' claim to ISO4 prices for the energy associated with the full 136 MW of the Unocal project is merely a strawman constructed to make the settlement offer seem more reasonable. Under Edison's view of the Unocal contract, the price of energy in the settlement offer would actually exceed the price in the original contract. Edison believes that complainants' attempt to get the Commission to approve its proposal is an effort to negotiate with the Commission rather than with Edison.

The requested relief is also inconsistent with the Commission's policy, according to Edison. Granting the relief would amount to compelling the utility to purchase power at prices greater than its avoided cost, in violation of Section 210 of PURPA. As noted previously, Edison thinks complainants' claim of bad faith is merely an attempt to bring an application for a new nonstandard contract before the Commission, as complainants' counsel essentially acknowledged in his opening statement. The Commission has also stated its policy that the guiding standard for review of nonstandard contracts is the economic indifference of ratepayers; that is, the nonstandard agreement should be the economic equivalent of a comparable standard offer. Even if complainants' economic analyses are accepted at face value, ratepayers are not indifferent to this contract because of the great detriment that ratepayers would incur if a precedent allowing contract brokering and site switching were to emerge from this case.

In Edison's opinion, this case presents a clear test of the Commission's policy on site switching and contract brokering. Edison points out that DRA's proposed guidelines on negotiating ISO4 contracts would not permit complainants' proposed amendments. The facts show that this complaint is an attempt to transfer a contract from the original project to a different project, the definition of contract brokering, according to Edison. The Carson project differs from the Brea project in numerous ways: the identity of the participants, the date of the start of construction, the project's size and location, the technology to be used, the use of the recovered heat from the cogeneration process, the interconnection point with Edison's system, the amount of power to be purchased by Edison, the project's design, and the fuel or energy source.

Moreover, it is clear that the project cannot succeed under the terms of the original contract without a number of material changes to reflect these differences.

5. The Project's Cost to Ratepayers

Edison calculates that the project's costs for ratepayers exceed its benefits by about $140 million. The calculations are based in part on Edison's rejection of complainants' contention that unquantifiable societal benefits justify payment of more than the current avoided cost. Edison points out that complainants have admitted that the project would not be built if payments were limited to current avoided cost. Edison also believes that this issue has previously been decided by the Commission:

> "Further, while societal considerations have always been important to the Commission, we do not view the development of avoided costs as an avenue for determining whether certain technologies or owners should receive preferential financial assistance based on overall societal benefits. There are undoubtedly proponents of other worthwhile projects who could and would argue that their projects provide equally important benefits to society. Opening the standard offer process to consideration and resolution of such broad policy issues would unnecessarily complicate, politicize, and lengthen what is already a cumbersome process." (D.85-07-021, mimeo. pp. 31-32.)

Edison is willing to honor the original contract, although it estimates that this contract would cost ratepayers between $135 million and $200 million in overpayments. Edison believes that the Brea project is not viable, and it argues that to permit the project to move to the Carson site would ensure that ratepayers would in fact incur those overpayments.

Even the May 26 settlement offer would cost ratepayers $61 million, according to Edison's calculations. Branchcomb's analysis was flawed because it compared only the choice between a 1989 on-line date and a 1992 on-line date for the project. Edison's estimates are based on a comparison of the project's costs with the current avoided cost during the period of operation under the settlement offer, 1992-2012. It performed six sensitivity analyses that convinced it that ratepayers should not incur the risks associated with the settlement offer.

Finally, Edison argues that the Commission should not undermine Edison's management discretion to negotiate with QFs by forcing Edison to accept the settlement offer.

C. <u>Other Parties' Positions</u>

1. <u>DRA's Position</u>

DRA opposes complainants' requested relief. DRA argues that the relocated project would be a wholly different project from the Brea project contemplated in the original contract, and that granting complainants' request would allow brokering of the contract. In addition, DRA believes that the amended contract requested by complainants would not leave ratepayers indifferent and thus would fail one of the important tests the Commission has applied in similar situations.

DRA acknowledges the physical similarity of the two projects, but, like Edison, DRA notes the change in Unocal's participation in the Carson project. At Brea, Unocal would have received synthesis gas, process steam, and electricity for its own use, but at Carson Unocal would receive only the profits from the sale of electricity. This difference, among others, persuades DRA that the two projects are distinct.

DRA argues that ratepayers would face increased risk under the contract requested by complainants. Like the original contract, the amended contract would require payments of $179 per kilowatt-year for 70 MW. But the amended contract would also fix payments at $103 per kilowatt-year for an additional 66 MW. Fixing the price for the additional payments is an added risk for ratepayers, and one that DRA does not feel that ratepayers should bear.

According to DRA, the discussion of the benefits of the Carson project is irrelevant to the resolution of the complaint, because of DRA's conclusion that the two projects are separate and distinct. Complainants have no right to an amended contract, DRA concludes.

2. **PG&E's Position**

This case presents a clear example of the issue of brokering of ISO4 contracts, in PG&E's view. PG&E believes that Unocal is trying to sell its ISO4 contract for $10 million to the partnership formed by complainants. The record is clear that Texaco and Fluor were not participants in the Brea project, and PG&E believes that they are currently seeking Unocal's ISO4 because they were unable to obtain an ISO4 for the Carson project before the offer was suspended. PG&E notes that Texaco first approached Unocal within a few weeks of the suspension of ISO4.

The true nature of this sale is revealed in the letter agreement of January 27, 1986 (Ex.6), and the draft partnership agreement (Ex. 7). According to PG&E, these documents make clear that Unocal's sole capital contribution to the partnership would be the assignment of its contract to the partnership, a contribution judged by the parties to be worth at least $10 million. In PG&E's opinion, the arrangements discussed in these and other documents make it clear that this is a case of contract brokering.

PG&E asserts that the Commission stated that standard offer contracts would be available for well-defined, site-specific projects and should not be used for speculation (D.85-04-075). The adoption of the screening criteria in the QF milestone procedure (D.85-01-038) reinforces this conclusion.

PG&E agrees with Edison that the failure of Edison and complainants to reach an agreement does not amount to bad faith.

PG&E cites Friant v. PG&E, D.83-06-109, as stating that the obligation to negotiate in good faith with QFs does not mandate a particular result to the negotiations.

Finally, PG&E asserts that complainants are improperly using the complaint procedure to obtain the Commission's approval of a nonstandard contract.

D. Complainants' Reply

Complainants think that the opposing parties ignore or distort the facts. Complainants believe that the record establishes the following facts:

> "(a) Complainants requested, in a straightforward manner, relocation/assignment of the Unocal Contract; (b) Edison agreed, subject to the resolution of stated concerns and the fulfillment of specified conditions; (c) such concerns were apparently resolved and the required conditions fulfilled; and (d) Edison unilaterally changed its mind in order to insulate itself from any risk and after needlessly committing Complainants to the expenditure of considerable time and resources."

Complainants believe that DRA ignores certain key facts and that Edison and PG&E distort the relevant facts.

On the allegation that complainants seek to engage in contract brokering, complainants make several points.

First, complainants continue to feel that this question is irrelevant to the resolution of their complaint.

Second, complainants point out that brokering suggests an intermediary, who for a commission will bring seller and buyer together. In this case, the parties have remained the same from the outset. Although the precise legal arrangements between the complainants may differ from those that would have been in effect if the project had remained at Brea, the three complainants would have been involved in any event.

Third, Edison's own actions indicate that it had no reservation about the proposed transfer of the project and that it did not believe that there was or should be a blanket prohibition against transfering projects.

Fourth, in a memo of February 26, 1986, from Edison's Bunnell to Nola, it is clear that Edison did not consider complainants' request to be a brokering of the Brea contract:

> "At the time the Brea contract was signed, it appeared that both Unocal (then Union Oil) and Texaco were considering taking a leading role in a coke gasification project. Edison was a participant in a feasibility study conducted with Texaco and Fluor, while Unocal was moving forward on its own.
>
> "However, it seemed common knowledge that only one project would be built. Unocal took the precaution of signing a Standard Offer 4, while the Texaco group only recently made a decision to proceed with contract negotiation. Since Texaco owns the coke gasification technology, they would have been involved in either case, at least as a vendor. This new request probably represents the consolidation of all of the interested parties around one form of the project rather than, as either a move of a project from one location to another, or as one project buying another SO 4 contract and running with it." (Tr. 152.)

Finally, complainants remind DRA and others that any policy the Commission may have against contract brokering is directed against projects that are not in the public interest. Therefore, a threshold question to any analysis involving contract brokering is whether or not the project is in the public interest. Complainants believe that they have demonstrated that the public interest is served by their requested assignment and that, even on its own terms, DRA's objection to its request should be rejected.

Complainants' respond to DRA's concern about the risk for ratepayers by pointing out that fixed price contracts <u>per se</u> are no more risky than a contract that reflects current prices. The real question in complainants' view is whether the certainty of fixed prices is worth the risk that later prices will be lower. Viewed in this way, complainants believe that their requested amendments present no greater risk to ratepayers than a contract based on floating prices.

In connection with this point, complainants state that their calculation of the contract's benefits, which develops long-term costs based on a projection of short-term avoided costs, is the only approved way of developing long-run avoided costs under the Commission's decisions. From the suspension of ISO4 to submission of this case, the Commission had not approved any other method for developing long-run avoided costs.

Complainants reject the allegation that their bad faith claim is based on Edison's failure to agree with them. Complainants assert that their claim is based on Edison's breach of its duty to respond promptly with truthful and timely explanations of its position. Complainants also point out that Edison's claimed counteroffer of the SO2 contract was no counteroffer at all, but merely stated what already existed: the availability of SO2.

Complainants also dispute Edison's claim that its rejection of complainants' proposal was reflected in a memo of February 14, 1986. If that memo is deemed to reflect a rejection of the proposal, then Nola's letter to Commissioner Calvo's office of April 1 must be viewed as reflecting a withdrawal of that rejection. Complainants argue that these documents support their claim that their proposal was not rejected until August 24, 1986.

Edison's claim that the proposal was not well defined is refuted by the many details set forth in the attachment to Unocal's letter of February 19, 1986. Complainants also point out that Edison never conveyed any information to them that suggested that Edison placed any significance on voltage support or dispatchability. Complainants think that the Commission should give no weight to Edison's position that these issues prevented the parties from reaching an agreement.

E. Edison's Reply

Edison believes that it met the Commission's good faith requirements in its dealings with complainants. It made timely counteroffers and gave explanations. Negotiations were not strung out, as complainants allege, as shown by the fact that all of the negotiations, from the presentation of the proposal in February until Edison's rejection in August, consumed only a total of six months.

Edison also points out that the Commission requires either a counteroffer or an explanation, and thus Edison was not always obliged to explain its position when it presented a counteroffer. The important question, in Edison's view, is whether any explanation was needed at a particular point in the negotiations.

For example, Edison believes that no explanation was required when it exercised its contractual right to terminate the contract. The contract clearly stated the right and required any waiver of this provision to be in writing. Complainants' letter of November 17, 1986, requesting Edison's assurances about the termination issue implicitly acknowledges that only a written waiver would meet the requirements of the contract.

Edison denies complainants' assertion that it encouraged the relocation/assignment or that it waived the requirement for starting construction by the date specified in the contract.

Edison continues to believe that complainants' actions amount to brokering of the contract. Contract brokering is against the Commission's policy, as was made clear in its report to the Legislature on "pioneer" QFs. Edison states, "It would be inconsistent for the Commission to order Edison to perform the very actions it condemns as imprudent to the Legislature."

Moreover, Edison believes that the contract is not in the public interest. The prices in the ISO4 were based on economic forecasts made in May and June 1983 that were declared to be dangerously out of date in April 1985, when the ISO4 was suspended. To grant complainants an opportunity to reinstate such prices would almost certainly result in unnecessary harm to ratepayers.

F. DRA's Reply

DRA's reply clarifies that it takes no position on whether or not Edison has acted in bad faith towards complainants. But DRA continues to believe that the requested relief is not in the public interest. DRA views the proposed assignment and relocation as a means of circumventing the suspension of ISO4, which is equivalent to brokering the contract.

The fixed capacity payments of either the contract or the settlement offer pose an added risk for ratepayers, DRA continues to assert. Such fixed payments are a gamble for ratepayers, regardless of whether they compare favorably or unfavorably with today's outlook of future prices. In addition, such fixed payments provide an undeniable benefit for complainants because they add to the predictability of the project's revenue stream.

DRA adds that even if Edison and complainants had reached agreement on modifying the contract's terms, DRA would have opposed the revised contract as a disservice to ratepayers.

III. Discussion

A. Background

When we chose to develop the standard offers to fulfill in part our obligations under PURPA, one of our hopes was that the existence of the standard offers would avoid the necessity of detailed review of individual contracts between utilities and what promised to be a multitude of QFs. The economic and natural resources of California seemed particularly well suited to the development of the independent generators that PURPA was intended to stimulate, and we concluded that a case-by-case review of individual contracts would soon prove to be unwieldy. Thus, we engaged in the sometimes tedious and laborious task of developing form contracts that the utilities were required to offer to QFs. Once we approved these standard offers, the utility's purchases under the contracts were presumed to be reasonable, and we hoped that this prior approval and presumption of reasonableness would also speed up the review of the reasonableness of the utility's overall purchases.

The standard offers were also designed to neutralize the tremendous bargaining power of the utility as the only purchaser of the QF's power. We adopted several requirements to ease negotiations between utilities and QFs, but the QF's ultimate bargaining power was its right to accept the standard offer if it could not come to different terms with the utility.

Once the QF and the utility signed a contract--either one of the standard offers or a negotiated contract--we had hoped that our subsequent role would be limited to the usual review of the reasonableness of the utility's purchases and administration of its contracts with QFs. If later disputes developed between the utility and the QF about the interpretation or implementation of the contract, we presumed that the parties would turn to the common resources for resolving such disputes--negotiations, arbitration, and, if necessary, the courts.

Complainants have stated their complaint in this case in a way that is apparently intended to fall within the limited role we have said we would assume in these disputes. Nevertheless, it is now clear that the primary points of the complaint boil down to disputes that frequently arise around contracts of all types and that have been addressed in several hundred years of contract law. Very little in this complaint requires our special expertise to resolve; most of the issues could have been handled by the normal means of dispute resolution.

At this point, having accepted the complaint, conducted the hearings, and evaluated the arguments of the briefs, we will not direct the complainants to another forum. But neither will we ignore the principles that have developed over the years to resolve these issues. Although the parties have to a large part declined to characterize their disputes in terms of contract law, we find that our analysis of these issues is greatly aided by referring to the general principles of the law on contracts and agreements. Our discussion will largely follow this analysis.

B. <u>The Unocal Contract</u>

Our analysis begins with the contract between Unocal and Edison, signed on December 5, 1984. The contract was based on interim ISO4, but there were several terms that differed from the standard offer (see Ex. 14, pp. 4-5, Appendices D and E).

A minor dispute arose during the hearings about whether the contract was or was not an ISO4 contract. It appears that all parties now agree that the contract is a nonstandard contract based on ISO4.

We agree with this characterization of the contract. As a general rule, a contract with only very minor changes from a standard offer might still be regarded as a standard offer. The Unocal contract, however, contained several changes that were bargained over, with each party receiving a concession from the other as part of the agreement to include the changed provisions (Ex. 14, pp. 5-6). When the parties have made mutual concessions to obtain desired changes on substantial terms of the standard offer, the resulting agreement should be viewed as a negotiated or nonstandard contract.

Complainants have argued that the Brea project and the Carson project are essentially the same project. At the time of the signing of the Unocal contract, it is clear from the record that the two projects were proceeding along separate paths. Texaco continued to discuss with Edison the arrangements for a contract to cover its project, and as late as March 1985, the possibility of Edison's participation in the Texaco project was still open (Ex. 14, Appendix F). None of these discussions would have been necessary if the parties had regarded the Brea project and the Los Angeles Coke Gasification Project as the same project. And, as we will discuss, the eventual proposal for the Carson project differed in several important respects from the project described in the Unocal contract.

C. The Proposed Modifications

To accomplish the goal of transfering the Unocal contract to the Carson project, complainants required three separate changes to the Unocal contract. First, the contract had to be assigned to the partnership, and under the terms of the contract this assignment required Edison's consent. Second, several terms of the contract had to be amended to reflect the differences between the Brea project and the Carson project. Edison had to agree to these amendments before the amended contract could be valid. Third, the contract gave Edison the right to terminate the contract if construction had not begun by December 1, 1986. Complainants needed Edison's agreement either to amend this provision or not to enforce its rights under this provision. We will address each of these provisions separately.

1. The Assignment

The Unocal contract specifically provides for assignments in Section 21:

> "Neither Party shall voluntarily assign its rights nor delegate its duties under this Contract, or any part of such rights or duties, without the written consent of the other Party.... Any such assignment or delegation made without such written consent shall be null and void. Consent for assignment shall not be withheld unreasonably."

The contract itself supplies the answers to the issues concerning assignment. Edison's written consent to the assignment was required for a valid assignment. However, Edison had no right to withhold its consent unreasonably. Edison could reasonably inquire about the ability of the partnership to fulfill Unocal's responsibilities under the contract. Once those inquiries were satisfied, however, Edison should have responded to the formal request for assignment of February 19, 1986, with its written consent to the assignment. This record reveals no reason for Edison to have withheld its consent, and we conclude that Edison was bound under the contract to give its written consent to the requested assignment from Unocal to the partnership.

It is important at this point to clarify exactly what such an assignment entailed. An assignment merely replaces one party to a contract with another party. The new party assumes the rights and duties stated in the contract, and those rights and duties are not changed unless the contract is amended. Assigning the contract to the partnership would merely obligate the partnership to build the project at Brea and to sell the required amount of power to Edison at the terms specified in the contract. The assignment would not accomplish the relocation, which required several amendments to the contract, as was recognized in Unocal's request for the assignment.

As things developed, the request for assignment got completely mixed up with the request for relocation. Because the bare assignment of Unocal's rights and duties was virtually meaningless to complainants without the relocation to the Carson site, complainants never pressed the issue of the assignment alone. Edison's failure to grant its written consent to the assignment never really affected the complainants. Thus, we conclude that under these circumstances, Edison's failure to grant its assignment was harmless.

2. The Relocation Amendments

The heart of the complaint concerns Edison's reactions to complainants' request for relocation. In terms of the Unocal contract, the request was for amendments needed to convert the Unocal contract into a valid contract covering the Carson project. Among other terms, the provisions setting forth the size and location of the project needed to be changed. Without these amendments, the mere assignment of the Unocal contract to the partnership would have the effect of obligating the partnership to build and operate the Brea project as described in the original contract.

a. Specific Amendments

Discussions with Edison about a relocation began as early as February 1985, but complainants made their initial written mention of such amendments in the letter of February 19, 1986, from Keith Openshaw, a senior vice president of Unocal, to E. A. Myers, an Edison vice president (Ex.14, Appendix H). However, this letter focuses primarily on the assignment and only briefly mentions the need for amendments. The letter promises a list of needed modifications at a later date.

So far as the record reveals, the detailed list of modifications was never supplied to Edison. Discussions seemed to have turned to the general question whether Edison would consent to a relocation, and the record does not demonstrate that complainants' specific contract amendments were ever communicated to Edison.

If a specific proposal had been presented to Edison, it would have been in complainants' interest to provide evidence of that fact. From complainants' failure to present such evidence, we may conclude that no specific list of proposed amendments was communicated to Edison.

This fact leads to two conclusions. First, we conclude that Edison never expressly accepted the amended contract that complainants desired, because no such offer was ever communicated to Edison. Second, for the same reasons, Edison cannot be found to have negotiated in bad faith concerning specific amendments to the Unocal contract. However Edison's duties in negotiations with QFs are defined, no duties arise unless and until a QF makes an offer or presents a proposal.

These conclusions help us define the issues in this case more clearly. A utility's duties in negotiations with QFs must be evaluated in terms of the specific offer or proposal that the QF presents for the utility's response. The specific proposal that complainants presented to Edison was the request for Edison to consent to the relocation and to agree to negotiate, sometime in the future, specific amendments to the Unocal contract.

b. <u>General Agreement on Relocation</u>

The narrowed question for our resolution thus becomes whether Edison ever agreed in concept to the relocation and agreed to negotiate appropriate amendments to the the Unocal contract.

(1) **Express Agreement**

From our review of the record, it is clear that Edison never expressly consented to the concept of the relocation nor agreed to negotiate appropriate amendments. On all occasions when Edison expressed support for the relocation, it also stated either conditions to its consent that were never fulfilled or proposals for other amendments that complainants never agreed to.

This conclusion may be illustrated by considering the details of one of the times when Edison seemed closest to consenting to the relocation proposal. In March of 1985, Edison had been viewing the relocation favorably, but it withheld its unconditional consent because it wanted to consult with members of the Commission's staff. The staff also seemed to favor the relocation, and Edison sought to confirm the staff's approval in the letter of April 1, 1986, from Sebastian Nola of Edison to

Commissioner Calvo's office. The letter's closing comes close to stating Edison's conditional consent to the relocation:

> "Please let me know if the above remains your understanding, for we plan to proceed with the assignment and relocation based upon your input and suggestions."

The letter seems to say that if staff confirmed the understandings described in the letter, then Edison would consent to the relocation.

Two points, however, prevent us from coming to this conclusion. First, the letter may also be read as soliciting staff's suggestions for Edison's consideration in formulating its ultimate position on the relocation question. Second, and more important, the letter clearly indicates that Edison did not intend at this time to accept complainants' relocation proposal without further negotiations. Perhaps as a result of its earlier discussions with staff, Edison recognized at this time that the California Energy Commission's permit for the project was required, and that the CEC was unlikely to grant that permit unless added dispatchability provisions were included in the contract. For these reasons, the letter states, "Edison will attempt to negotiate dispatchability provisions into this contract."

Our conclusion that no meeting of the minds occurred at this point is confirmed by the notes from a follow-up meeting between Edison and complainants. The notes record that complainants' representatives "indicated general agreement with the terms described in the letter with the exception of the requirement to add dispatch features to the agreement."

Our impression is that this was the point when the parties came closest to agreement. Before this time, Edison made it clear that it wanted to discuss the relocation with the Commission's staff before it would agree to the relocation. Edison's consent in later discussions was conditioned not only on increased dispatchability, but also on adequate approval from a

Commissioner (the approval received was too contingent and ambiguous to supply the assurance Edison desired) and later on a formal order from the Commission, which was never sought.

Thus, Edison never unconditionally accepted complainants' proposal to relocate the project, and complainants never accepted Edison's counterproposals. The meeting of the minds that is the essence of a legally enforceable agreement never occurred.

Another type of express agreement may be formed when a party agrees to perform some act on the occurrence of a stated condition. For example, if Edison had stated that it would agree to the relocation when a formal order was received from the Commission, then it would be bound by its agreement when the stated condition, the Commission's formal approval, occurred. Complainants sometimes seem to suggest that they repeatedly met such conditions, only to be confronted by another condition to Edison's consent to the relocation.

From our review of the record, we can find no instance when Edison stated that it would agree to the relocation if a certain occurrence took place, and then balked on its commitment when the event occurred. It is uncontested that Edison sought various levels of approval from the Commission's staff and from Commissioners, but we can find no clear record that its consent to the relocation was contingent on the receipt of these approvals.

Thus, we cannot conclude from the record before us that a contract was formed upon the satisfaction of a specified condition.

(2) <u>Implied Agreement</u>

The conclusions of the preceding section lead to the next question and to the core of complainants' argument: Should Edison's consent to the relocation and agreement to negotiate amendments to the Unocal contract be implied, either under the doctrines of contract law or under the duties that the Commission has imposed on utilities in their negotiations with QFs?

The law recognizes two types of implied contracts. The first, fully described as an contract implied in fact, arises when the parties' assent to an agreement is manifested by conduct, rather than in words. Nothing in the record in this case suggests that Edison ever consented to complainants' relocation proposal by its conduct, rather than verbally.

The second type of implied contract is the contract implied in law. The law will create an obligation, without regard to the intentions of the parties, when one party receives an benefit which it may not justly retain. A contract implied in law corrects this unjust enrichment and restores the harmed party to its former position. Again, nothing in the facts of this case suggest that any party has been unjustly enriched.

Another legal doctrine that could conceivably apply in this case is promissory estoppel. If, for example, Edison had indicated to complainants that it would consent to the relocation and complainants substantially changed their position in reliance on that representation, Edison's representation would be enforced, even if it received nothing in exchange for its promise, if enforcement was the only way to avoid injustice. But, again, there is nothing in the facts demonstrated in this case that would call for the application of this doctrine.

Thus, we conclude that there is no basis in law for implying that Edison consented to the relocation proposal.

c. <u>Duty to Negotiatiate in Good Faith</u>

The final part of our analysis will consider complainants' assertion that Edison's behavior was a breach of its obligation, created by the Commission, to negotiate in good faith with QFs.

This duty was created in D.82-01-103, when we adopted the standard offer concept and set the ground rules for transactions between utilities and QFs:

> "The utilities are expected and shall be required to bargain conscientiously toward a conclusion. The best evidence of good faith is a collection of written documentation compiled along the way. When the utility is unwilling or unable to accept a QF's proposal, the utility must respond with a timely counteroffer, or an explanation...of:
>
> "1. The specific information needed to evaluate the proposal;
>
> "2. The precise difficulty encountered in evaluating the proposal; and
>
> "3. The estimated date when it will respond to the proposal." (D.82-01-103, p. 106.)

Complainants assert vigorously that Edison has breached this duty in its dealings with complainants.

(1) <u>The Nature of the Utility's Duty</u>

A primary problem with complainants' argument is that it ignores the context in which this duty arose. The negotiations referred to in this quotation were the negotiations leading up to a contract between a utility and a QF. At the time of its dealings with complainants, Edison had no reason to believe that the Commission intended these specific obligations to apply to negotiations to modify a contract that had already been sucessfully negotiated.

Thus, our task is to define what obligations towards QFs we should expect Edison to have had during 1986, when its negotiations with complainants took place, in the context of proposed modifications to an existing contract. As a party to a valid and binding contract, Edison had an obligation to deal with the other party fairly and in good faith with respect to contractual matters. Certainly, Edison should have recognized that it had a continuing obligation of good faith in its dealings with complainants as a QF. The specific requirements established in D.82-01-103, however, could not reasonably be expected to apply; since complainants' proposals were never presented in a precise and complete form, it would have been difficult for Edison to have responded within the limits set in D.82-01-103.

The general duty of good faith obligated Edison to respond quickly and frankly to complainants' questions and proposals. However, it must be recognized that the difference between the negotiations toward a contract contemplated in D.82-01-103 and the negotiations toward amendments that are the subject of this case had a significant effect on the nature of the duty of good faith.

The duty created in D.82-01-103 was designed to check, at least in part, the overwhelming bargaining power of a utility that is essentially the only buyer in the market. The specific steps we required from the utility were intended to ensure that the utility would not needlessly delay negotiations and would be honest and fair in making known its legitimate objections to a QF's proposal.

Once a contract is created, however, the positions of the parties change dramatically. The utility, like the QF, has rights and obligations, specifically set forth in the contract. It has promised to perform certain duties, and it has a right, enforceable in court if necessary, to receive the performance promised by the QF. The bargaining imbalance is transformed by the contract into a relationship defined by mutual agreement. In terms of the private law created in the agreement, the parties are equal, and both parties are equally subject to the public law's sanctions for failure to live up to their promises.

These principles help illuminate the proper duty and behavior of Edison when presented with the relocation proposal. At the time the relocation was proposed, Edison had the right to enforce, if it chose, the terms of original Unocal contract (with the possible exception of the changes resulting from an assignment, as previously discussed). Although some of the changes that presumably would be required by complainants' request were minor and had no real effect on the relative positions of the parties, other changes were substantial. For example, to comply with the request for relocation, the contract would have to be amended to reflect the increased size of the relocated project (136 total MW at Brea versus 174 MW at Carson). In addition, because of the change in the thermal requirements of the associated processes, the expected net capacity sales to Edison would increase from 70 MW at the Brea location to 142 MW at Carson (although the amount sold at SO2 prices, the capacity price option selected by Unocal in the contract, would remain at 70 MW).

Edison was correct in viewing this increase as a substantial change in the relative positions of the parties. The primary reason for the suspensions of ISO4 and SO2 was a fear that the capacity payments under these offers were too high in relation to the utility's true avoided costs. This perceived overvaluing was to a large extent a function of the rapid and unanticipated growth in capacity to be supplied by QFs.

Thus, Edison's situation at this time was this: It had a right under the Unocal contract to accept no more than 70 MW of capacity at SO2 prices and 66 MW at SO1, as-available capacity prices. It had received a general proposal to amend the contract to require it to accept additional capacity from the project. The terms under which this capacity would be purchased were somewhat unclear. At a minimum, the relocation would require the purchase of at least 6 additional MW of as-available capacity. The proposal was initially presented, however, as an increase in the contract capacity from 70 MW to 135 MW. This increase was first proposed at the ISO4 prices, although Edison quickly rejected this proposal, since ISO4 had been suspended (Ex. 14, Appendix G). Later discussions seemed to assume that the additional capacity would be firm capacity, presumably sold at some version of SO2 prices.

How should Edison have responded in these circumstances? At the outset we should note that we have only recently adopted guidelines to govern the utilities' behavior in negotiations of contract modifications with QFs. At the time, obviously, Edison did not have the benefit of these guidelines, and although Edison should have been aware of the guidelines' underlying principles, it would be unfair to apply the specific guidelines retrospectively (D.88-10-032, mimeo., p. 39).

We think it was reasonable for Edison to consider the effect on ratepayers of the substantial modifications that were needed for the relocation. Edison knew at this time that we expected negotiated agreements to be the economic equivalent of our approved standard offers (D.82-01-103, p. 91), and Edison should have made the logical extension of this principle to the results of negotiations to amendments to existing contracts. In evaluating proposed amendments to a contract, Edison should have analyzed both the costs to and benefits for ratepayers that would result from the changes. If, after considering the various aspects of the contract, Edison concluded that the amended contract was no worse for ratepayers than the existing contract, then Edison should have consented to the relocation, assuming that no other concerns superseded this evaluation.

The standard we have just set out is a minimum standard, a threshold test for considering proposed amendments. Certainly it would have been reasonable for Edison to explore the possibility of gaining further benefits for ratepayers from the negotiations, especially in light of our expressed dissatisfaction with the price levels of ISO4. And a corollary of this principle is that if Edison concluded that the net effect of the necessary amendments was detrimental to ratepayers, it should have attempted to receive roughly equivalent concessions to maintain the ratepayers' economic indifference to the changes in the contract.

Edison alleges that its attempts to negotiate improved provisions on dispatchability and reactive power support were motivated by this consideration. Complainants view the reference to dispatchability and reactive power support as a red herring, fished out after the fact to divert attention from Edison's bad faith.

The record indicates that the issues of dispatchability and reactive power support were raised repeatedly throughout the negotiations. The notion of including increased dispatchability was first raised in the preliminary negotiations of February 14, 1986 (Ex. 14, Appendix G). Unocal's written request for relocation of February 19 (Ex. 3, Ex. A; Ex. 14, Appendix H) included a discussion of dispatchability and reactive power support and indicated that complainants were willing to negotiate appropriate modifications with Edison. The April 1, 1986, letter also stated that Edison would attempt to negotiate improved dispatchability provisions into the amended contract (Ex. 14, Appendix I). By April 18, 1986, complainants were unwilling to increase dispatchability, but the issue seemed to remain part of the negotiations (Ex. 14, Appendix J). The issue of dispatchability surfaced again in the meeting of September 25. Even as Edison rejected complainants' request for the relocation and assignment, it included dispatchability as a desirable element of a new contract (Ex. 14, Appendix N). And the final negotiations between the parties centered on the issue of dispatchability (Ex. 14, Appendix O).

We conclude that the issue of increased dispatchability was not a diversion but was a central element throughout the negotiations between the parties. We also conclude that improved dispatchability was a logical and reasonable concession for Edison to seek in exchange for accepting additional firm capacity from the project. The value of capacity varies throughout the day and with the seasons. Increased dispatchability meant that Edison could use the capacity it was obliged to purchase at those times when it would be most valuable to Edison's system, thus minimizing any overpayments that would result from changes in forecasts of the value of capacity.

(2) <u>Consideration of the Project's Benefits</u>

Complainants respond that Edison should have also considered the additional benefits associated with the relocated project in reaching its decision on the relocation request.

As we have discussed, we agree with the general principle that the utility's evaluation of proposed amendments should consider both the costs and benefits for ratepayers of the proposed amendments. Complainants urge that the benefits of their proposed contract to a broader group than just ratepayers should be considered.

Complainants' list of benefits of the Carson project include the demonstration of new technologies with environmental benefits, direct benefits to Edison's ratepayers, the reduction of environmental pollutants, reduction of dependence on imported oil, increased load-following abilities, reduction in transmission losses, and indirect benefits to Edison's ratepayers and other Californians in the form of reduced oil imports, increased in-state oil refining, and increased employment.

Complainants' list of benefits raises several issues. First, in D.82-01-103 we considered how to regard societal benefits in the calculation of avoided cost:

> "These 'social costs' include the risks associated with imported energy supplies and environmental degradation related to conventional generation. While several parties suggested that we explicitly include 'social costs' in the avoided cost calculation, we are not including such factors at this time. We prefer to recognize social costs in the general

> policy judgment that QF production is competitive at avoided costs." (D.82-01-103, pp. 25-26.)

Translated into the terms of this case, these principles mean that larger social benefits do not in themselves justify the payment of higher prices to the QF, as complainants recognize. It is clear that the Carson project has tremendous potential to demonstrate some enormously beneficial technologies, and we believe that the record shows that Edison recognized these benefits from the outset. However, the question of how much ratepayers must pay to support those benefits had to dominate Edison's consideration of the relocation.

Another aspect of complainants' argument is an analysis of the direct economic benefits to ratepayers. A large part of this analysis considers the effect of a settlement offer that complainants made to Edison on May 26, 1987. However, the evaluation of Edison's good faith in negotiating with complainants requires us to consider only the information that was available to Edison at the time of the alleged bad faith. The settlement offer, which we will later discuss in detail, was not conveyed to Edison until well after the period of the direct negotiations.

Thus, the analysis of direct economic benefits that Edison should have performed in response to Unocal's request should compare the Unocal contract with the contract that complainants were seeking in their relocation request. This comparison, as performed by complainants' witness, resulted in net costs ranging from $80 million to $194 million for ratepayers under the four scenarios considered. Although Edison did not apparently perform such a detailed analysis, the record is clear that Edison was concerned about the cost of the proposed modifications from the beginning of negotiations.

The indirect benefits listed by complainants also present at least two problems. First, many of the listed benefits flow to a broader segment of society than just Edison's ratepayers, although the relevant costs of producing these benefits is borne only by Edison's ratepayers. For example, reduction of environmental air pollution will benefit the customers of the Los Angeles Department of Water and Power, other municipal utilities, and possibly San Diego Gas & Electric Company, but those customers will bear none of the costs. Reduction of oil imports and stimulation of in-state oil refining benefits an even more diffused group, but the costs remain concentrated on Edison's customers. We do not require or expect costs and benefits to match perfectly in all instances, but fairness requires that a substantial benefit should accrue directly to those who bear the costs. It is difficult to give much weight to complainants' arguments on indirect benefits when the benefits are so attenuated and the costs are so concentrated.

A second problem with the consideration of indirect benefits is the mismatch between costs and benefits even within the class of Edison's ratepayers. A large industrial customer may use relatively little electricity but consume large quantities of imported oil; this customer will benefit from the reduction of oil imports but pay little of the cost. A residential customer who does not own a car may consume proportionally large amounts of electricity in relation to oil use; this customer will receive little benefit for the extra costs. These are extreme examples, but they illustrate the difficulties of evaluating indirect benefits.

In reviewing the record of Edison's behavior during negotiations with complainants, we conclude that Edison properly focused primarily on the direct costs to ratepayers of the proposed amendments, while it recognized and gave weight to the particular benefits that this project promises.

d. Conclusion

We conclude that Edison acted reasonably in attempting to gain concessions in the form of improved dispatchability and reactive power provisions in exchange for agreeing to the relocation. There is no evidence that these attempts were maintained unreasonably, in bad faith, or merely to prolong the negotiations. We also conclude that complainants never agreed to Edison's proposal.

We have also found that Edison never expressly or impliedly agreed to the general relocation proposal or to negotiate specific amendments to the contract.

We have concluded that Edison met the standard of good faith that it could reasonably have believed applied to its behavior during negotiations of this sort.

Our ultimate conclusion is that complainants are not entitled to the central element of their request, an order to Edison to consent to the relocation of the project from Brea to Carson.

3. The Construction Start-up Date

The final element of the proposed modifications is the extension of the construction start-up date set in the Unocal contract. The contract gave Edison a right to terminate the contract if construction had not begun by December 1, 1986. Edison exercised its right under the contract to terminate the contract, an act that quickly led to this complaint.

Complainants argue that part of Edison's bad faith is shown by its statements about its intentions with regard to its right to terminate. Complainants assert that the issue of the termination was raised by Texaco in preliminary discussions with Edison as early as July and August 1985. Complainants also contend that the subject came up during meetings with Edison on February 12 and 13, 1986, and that Edison's representatives said that the construction start-up date would not be enforced. This discussion does not appear, however, in Edison's memorandum summarizing the meeting. No further communications about this provision are reflected in the record until December 1, 1986, when Edison sent its formal notice of intent to terminate.

The evidence on this point is skimpy. The testimony concerning Edison's statement that it would not enforce the construction start-up date was not contradicted. We also deduce from the silence of the record on discussions during the intervening months that complainants had some basis for believing that the termination provision would not be exercised. We note that the parties were still discussing a possible new agreement as late as October 24, 1986, without mention of the construction deadline.

We conclude that Edison represented to complainants in February 1986 that it would not exercise its contractual right to terminate the contract if the construction start-up date was not met. Even if Edison received nothing in exchange for its promise, complainants reasonably relied on the Edison's promise and delayed beginning work on the project in reliance on Edison's representation. Under such circumstances, the law will enforce the promise under the doctrine of promissory estoppel. We believe that the circumstances in this case compel a similar result, and we conclude that Edison should be held to its promise not to enforce the construction start-up date.

However, we do not find the necessary support for complainants' requested finding that Edison's exercise of its termination rights constituted bad faith. As we have discussed, Edison retained all the rights that Unocal had agreed to give Edison under the original contract, including the termination provision, unless and until the contract was amended. It is Edison's <u>representation</u> that it would not exercise its termination rights that persuades us that the termination should not be enforced.

D. The Settlement

After the complaint was filed, the parties attempted to negotiate a settlement of the case. On May 26, 1987, Unocal presented a settlement offer that substantially changed its proposal for amending the Unocal contract. Edison did not accept the proposed settlement, and the case proceeded to hearing. At the hearing, Unocal presented the terms of the settlement offer as the basis for a contract it would accept if the Commission is inclined to grant it relief but is unwilling to reinstate the original contract.

We take Unocal's tender of the settlement offer as a realistic acknowledgement of the changes that have occurred since the prices of ISO4 were developed in May and June of 1983. However, we do not believe that our decision in this case should be swayed by the presence of the settlement offer; if Unocal is entitled to the requested relocation and assignment, the other original contract terms agreed to by the parties should be enforced. If Unocal is not entitled to the relocation and assignment, then the existence of a more attractive offer is irrelevant to our resolution of this complaint.

Throughout this opinion, we have stressed that standard offers, once accepted, are contracts between the QF and the utility and are subject to the same laws and principles as other commercial contracts. Any modifications to the contract should be negotiated and agreed to between the parties. In this case, the parties attempted to negotiate a settlement to the complaint, but those efforts were ultimately unsuccessful. While we do not believe that Unocal was attempting to negotiate with the Commission rather than Edison, introducing an offer that was not accepted by the other party to the contract could be perceived as interjecting the Commission into the contractual relations between the parties. We want to discourage this perception and to discourage other parties from trying to involve the Commission in contractual disputes. In this case, we think the settlement offer should be disregarded for purposes of our decision.

Our action should not be seen as discouraging settlements; we favor settlements and have set up procedures for our consideration and approval of settlements. But before a settlement is brought before us, it should be agreed to by at least some of the concerned parties. We encourage Unocal and Edison to continue to attempt to negotiate an arrangement that would permit the beneficial technologies to be demonstrated without undue cost to ratepayers.

IV. Conclusion

We have found that Edison should have responded promptly and favorably to complainants' written request for assignment of the contract and that Edison violated its earlier promise not to enforce its right to terminate the Unocal contract if construction was not started by December 1, 1986.

On the central point of the complainants' requested relief, however, we have concluded that Edison never expressly or impliedly agreed to the relocation or to negotiate appropriate amendments to the Unocal contract that would permit the relocation of the project from Brea to Carson. We have also concluded that Edison did not breach the duties imposed by the contract or by this Commission in its negotiations with complainants about the relocation. In light of the central importance of the relocation to complainants' requested relief, our conclusions that Edison did not act properly concerning the assignment and the termination appear to have no real significance.

Under the circumstances, complainants' requested relief is not justified, and the complaint should be denied. However, we wish to stress again that we think the project is a promising one, and we strongly encourage the parties to continue discussions to see if a way can be found to accommodate the various interests and come to an agreement that will allow the project to be constructed and operated.

<u>Findings of Fact</u>

1. Edison and Unocal entered into a contract based on ISO4 on December 5, 1984. The contract concerned the sale of 70 MW from a coke-fired cogeneration facility at Unocal's ammonia plant in Brea.

2. On February 19, 1986, Unocal asked Edison to assign the contract to a partnership consisting primarily of Unocal, Texaco, and Fluor.

3. The contract stated that Edison could terminate the contract if construction on the gasification facility and project did not begin by December 1, 1986.

4. On December 1, 1986, Edison notified Unocal of its intent to terminate the contract.

5. The Unocal contract contained several terms that differed from ISO4. The parties bargained about these terms and made mutual concessions in arriving at the agreement.

6. Negotiations over the Los Angeles Coke Gasification Project, with Texaco as the leading sponsor, continued after the Unocal contract was signed.

7. In its letter to Edison of February 19, 1986, Unocal stated that it would supply Edison with a list of amendments that were needed to have the Unocal contract apply to the relocated project at Carson.

8. Complainants did not supply Edison with a list of requested amendments to the contract to accomplish the requested relocation of the project.

9. The most specific proposal that complainants presented to Edison was a request for Edison to consent to the relocation of the project from Brea to Carson and to agree to negotiate, sometime in the future, specific amendments to the Unocal contract.

Under the circumstances, complainants' requested relief is not justified, and the complaint should be denied. However, we wish to stress again that we think the project is a promising one and, in the spirit of our policy favoring reasonable settlements of disputes, we would like point out an alternative which these two parties may want to evaluate. The most attractive approach may be to start afresh with a new contract under final SO 4 or the reinstated SO 2, both of which will be under consideration in our resource plan proceeding to commence shortly. We note that in a recent decision (D. 88-12-032) we offered that a settlement with such terms would leave ratepayers indifferent and yet maintain the viability of what we consider a promising technology.

In their comments on the proposed decision, complainants argue that the doctrine of promissory estoppel should apply to extend the firm operation date requirement of the contract. We have applied this doctrine to prevent enforcement of Edison's right under Section 3.3 to terminate the contract when construction did not start by December 1, 1986. Termination for failure to achieve firm operation within five years of the execution of the contract, or by December 5, 1989, however, is governed by a separate provision, Section 12.

According to the record in this case, complainants focused almost entirely on obtaining an extension of the first deadline they had to meet, the time for beginning construction. It appears that the question of extending the five-year limit for firm operation was not raised until November 1986. From our review, we find nothing in the record that suggests that Edison made any representations or promises not to terminate the contract if the project did not meet the required firm operation date. This sort of promise or representation is an essential element of the doctrine of promissory estoppel, and without such a promise we cannot use this doctrine to overcome the plain language of the contract.

10. Edison presented complainants with counterproposals concerning dispatchability and voltage support.

11. At the time it was considering the relocation request, Edison had a contractual right to require Unocal to perform its obligations under the Unocal contract.

12. The proposed relocation would have resulted in a substantial change in the relative positions of the parties to the Unocal contract.

13. Edison raised the issue of dispatchability on or about February 14, April 1, April 18, and September 25, 1986.

14. The Brea and Carson projects would provide a demonstration of beneficial technologies and would result in other benefits, including reduction of environmental pollutants, reduced dependency on imported oil, and increased employment.

15. Many of the benefits associated with the Brea and Carson projects would not accrue directly to Edison's ratepayers, although the costs of the projects would be primarily borne by Edison's ratepayers.

16. A comparison of the direct costs and benefits to Edison's ratepayers of the Carson project concludes that ratepayers would incur net costs ranging from $80 million to $194 million.

17. Edison represented to complainants in February 1986 that it would not enforce its right to terminate the Unocal contract if the start of construction was delayed beyond December 1, 1986.

18. Complainants reasonably relied on Edison's representation and did not take steps to begin construction by December 1, 1986.

19. Complainants presented a settlement offer to Edison on May 23, 1987.

20. Edison has not accepted complainants' settlement offer.

Conclusions of Law

1. The Unocal contract is a negotiated or nonstandard contract.

2. The Brea project and the Los Angeles Coke Gasification Project were not the same project.

3. Edison should have consented to the assignment of the Unocal contract to the partnership.

4. Edison did not accept an amended contract to allow relocation of the project, and complainants did not offer such an amended contract to Edison.

5. Edison did not negotiate in bad faith concerning specific amendments to the Unocal contract.

6. Edison did not expressly consent to the concept of relocating the project nor to negotiate specific amendments to the contract to permit relocation.

7. Complainants did not agree to Edison's counterproposals on dispatchability and voltage support.

8. No ground exists for finding that Edison impliedly agreed to complainants' relocation proposal.

9. In evaluating the relocation request, it was reasonable for Edison to consider the effect on ratepayers of the substantial changes to the contract that were needed to accommodate the relocation.

10. Edison did not act in bad faith in considering the request for relocation.

11. Edison should be held to its promise not to enforce its right to terminate the Unocal contract if construction did not begin by December 1, 1986.

12. The relocation is the central element of the complaint.

O R D E R

IT IS ORDERED that the complaint of Union Oil Company of California, Texaco Syngas, Inc. and Fluor Carson Inc. is denied.

This order becomes effective 30 days from today.

Dated ____________________, at San Francisco, California.

Under the circumstances, complainants' requested relief is not justified, and the complaint should be denied. However, we wish to stress again that we think the project is a promising one, and we strongly encourage the parties to continue discussions to see if a way can be found to accommodate the various interests and come to an agreement that will allow the project to be constructed and operated.

In their comments on the proposed decision, complainants argue that the doctrine of promissory estoppel should apply to extend the firm operation date requirement of the contract. We have applied this doctrine to prevent enforcement of Edison's right under Section 3.3 to terminate the contract when construction did not start by December 1, 1986. Termination for failure to achieve firm operation within five years of the execution of the contract, or by December 5, 1989, however, is governed by a separate provision, Section 12.

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We will not order the extension complainants request, but we encourage the parties to come to a reasonable accommodation on the firm operation date as part of their attempts to find a way to allow the construction and operation of this project to proceed. In a recent decision, D.88-12-032, we stressed the importance of the five-year deadline for firm operation. When a QF wants changes to fundamental provisions like the five-year deadline, "the utility should seek concessions based on its current projections of avoided cost" (D.88-12-032, mimeo, p. 23). We encourage the parties to negotiate within the guidelines we established in D.88-10-032 and the guidance we offered in D.88-12-032. In this particular case, we note that delaying the firm operation of the project may provide benefits in the form of a better match with Edison's needs for capacity.

Findings of Fact

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