

Decision 89 11 041 NOV 22 1989

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for an order approving the First Amendment to the Power Purchase Agreement for long-term energy and capacity between Axel Johnson Soledad, Inc. and Pacific Gas and Electric Company Inc. regarding deferral of the purchase of long-term capacity and energy from the Soledad Ecology No. 1 biomass facility.

ORIGINAL

Application 89-03-036  
(Filed March 23, 1989)

U-39-E

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## OPINION

### I. Summary

Pacific Gas and Electric Company (PG&E) and Axel Johnson Soledad, Inc. (AJS), have entered into an agreement to defer the on-line date of AJS's qualifying facility (QF) project. Under the agreement, AJS would be paid \$3.7 million total (\$2.9 million upfront) to defer the project for up to five years. By this application, PG&E seeks our approval of the agreement and prospective finding that PG&E's payments are reasonable and recoverable in rates.

We reject the terms of the agreement but indicate certain modifications related to the upfront payment that would make the agreement acceptable to us.

## II. Background

In 1985, PG&E entered into a Purchase Power Agreement (PPA) with a developer named Oeberst & Associates to purchase electricity from a 16 megawatt woodwaste facility located in Soledad, California (Soledad). Under the terms of the PPA, Soledad was required to be operational by June 27, 1990. In 1988, PG&E agreed to an assignment of the PPA to AJS.

Soledad's PPA reflected the terms and conditions of Interim Standard Offer 4 (ISO4). ISO4 provides for fixed payment rates over long time spans. There are three energy payment options and two capacity options. Each provides for pricing certainty in the form of fixed prices (ramped or levelized), based on forecasts agreed to at a 1983 negotiating conference among utilities, QFs, and Commission staff.<sup>1</sup>

For energy payments, the Soledad developer chose Energy Option 1, which provides for fixed energy prices equal to 100% of the forecasted price over a 10-year fixed price period. At the end of the fixed price period, energy payments are based on published avoided energy costs, which are updated every quarter. In addition, the developer chose Capacity Option 2, for projects providing firm capacity, and for which payments are based on fixed, levelized shortage costs. If Soledad starts firm operations in 1990, as planned, it would receive fixed capacity payments of \$196/kW-year over the 30-year contract.

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1 See D.83-09-054 on the development and payment terms of ISO4.

On June 8, 1988, the Commission issued an Order Instituting Rulemaking (R.88-06-007) requesting written comments on a proposed set of guidelines for negotiating modifications to standard offer contracts (Guidelines), including paid and nonpaid deferrals. In late summer, 1988, PG&E approached AJS to explore the possibility of negotiating a deferral for Soledad. On October 14, 1989, the Commission issued Decision (D.) 88-10-032 adopting final guidelines for these types of negotiations. On October 28, 1988, PG&E and AJS signed a letter agreement outlining the deferral. The final agreement, embodied in a First Amendment to the PPA, was executed on December 29, 1988. (See Attachment 1.)

On March 23, 1989, PG&E filed Application (A.) 89-03-036 requesting ex parte approval of the First Amendment. The Division of Ratepayer Advocates (DRA) filed a limited protest on June 7, 1989.<sup>2</sup> A day of hearing was held on July 24, 1989 before Commissioner Eckert and ALJ Weissman. Counsel for DRA, PG&E, and AJS presented closing arguments, in lieu of written briefs, at the July 24 hearing.

An ALJ's proposed decision was mailed to all parties on September 22, 1989. Comments were received from DRA, PG&E, and AJS. This opinion reflects substantive modification of the ALJ's proposed decision as discussed below.

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<sup>2</sup> By Administrative Law Judge (ALJ) ruling dated May 12, 1989, DRA was granted a six-week extension of the normal 30-day deadline for filing.

### III. The First Amendment

Under the First Amendment, PG&E would pay AJS to defer the Soledad project for up to five years.<sup>3</sup> PG&E would have the option of requiring AJS to shorten the deferral period upon two years' written notice. PG&E would pay AJS a lump sum deferral payment of \$3,675,000 structured as follows: (1) \$2,940,000 within 30 days of a final Commission decision approving the agreement and (2) \$735,000 plus interest when the project begins energy deliveries to PG&E.

The First Amendment also provides that ISO4 energy payments would be reduced from 100% of the fixed, forecasted prices to 90% forecasted and 10% published prices over the fixed price period. For the first 10 years of the contract, capacity payments would be reduced to \$186/kW-year, \$10/kW-year less than the amount to which AJS would be entitled if firm capacity availability were established in 1990.

Finally, the First Amendment provides AJS with an option to submit a new proof of site control, provided the project remains entirely within the current boundaries of the Soledad Industrial Park.

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<sup>3</sup> Under the First Amendment, the earliest Soledad could begin to receive ISO4 capacity and energy prices is June 27, 1995, five years after the original deadline. Energy deliveries could begin as early as March 1, 1995, but payment would be at non-firm, economy energy prices, with no payment for capacity. The latest date at which initial energy deliveries could begin is June 27, 1996.

#### IV. Position Of The Parties

The testimony in this proceeding focused on three issues related to the reasonableness of the First Amendment: (1) project viability, (2) benefits/risks to ratepayers, and (3) the lump sum deferral payment. The positions of the parties are presented, issue-by-issue, below:

##### A. Project Viability

The Guidelines adopted by the Commission in D.88-10-032 require examination of a QF's viability under the unamended contract as a prerequisite to modifications. The Guidelines include a list of various aspects of project development that should be considered in assessing a project's viability. (See Attachment 2.) The Guidelines further state that, in general, deferrals and buyouts should be considered only with QFs who have obtained all of the permits and certifications necessary to go forward with their projects.<sup>4</sup>

In PG&E's view, the proposed deferral fully satisfies the requirement of the Commission's Guidelines that a deferred project be viable. In support of this position, PG&E and AJS presented the following information on various aspects of the project's development:<sup>5</sup>

(a) Project Description and Interconnection Study Cost Request Form: A completed form was submitted to PG&E on April 12, 1985.

(b) Proof of Site Control: Proof of site control in the form of land option payments was provided on August 29, 1985. (TR at 45.)

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<sup>4</sup> D.88-10-032, Appendix A, Guideline 6.

<sup>5</sup> Except as otherwise indicated, this information is directly from Exhibit 1, Prepared Testimony of Daniel Mesfin of PG&E.

(c) Detailed Interconnection Study: A detailed interconnection study has been completed and a Special Facilities Agreement requested.

(d) Project Fee, Interconnection Priority: PG&E received proof that an escrow account had been established for the project fee on July 31, 1985. Interconnection priority was established on August 29, 1985, when proof of site control was submitted. The project is currently in compliance with the QF Milestone Procedure (QFMP).

(e) Permits: All major permits necessary to proceed with the project have been issued. The critical path permit, the Authority to Construct, was issued by the Monterey Bay Unified Air Pollution Control District on September 30, 1988. The other major permit, the Conditional Use Permit, was issued by the City of Soledad on July 20, 1988. (Copies of permits are attached to Exhibit 3.)

(f) Fuel Supply: AJS has concluded negotiations with Weyerhaeuser Corporation for a 10-year supply of woodwaste and a site for a woodwaste processing and cubing facility in Aberdeen, Washington. In addition, AJS initiated a long-term rail transportation agreement with Burlington Northern and Southern Pacific railroad companies as an optional fuel transportation mode. (Application, Exhibit E.)

(g) Feasibility of Construction By the Five-Year Deadline: The PPA five-year deadline for the Soledad project is June 27, 1990. Construction of both the Soledad facility and the Aberdeen fuel densification plant was to be by turnkey contract. AJS signed a letter of intent on September 30, 1988 with Ultrasystems Engineers and Constructors, Inc., and Energy Products of Idaho to construct the Soledad facility and Aberdeen fuel densification plant. The Letter of Intent describes the primary terms and conditions for turnkey construction of the facility and binds the parties to negotiate in good faith to a final contract.

This document included a fixed price for the design, engineering, and construction of the facility, including the equipment purchasing, performance and completion guarantees, liquidated damages, and bonus clauses. Under the Letter of Intent, the contractors would face severe penalties for failure to have the facility operational by the five-year deadline.<sup>6</sup>

(h) Equipment Procurement Status, Engineering, and Design Status: Under the turnkey contract described above, the contractors' obligation to have the facility operational by the five-year deadline included the obligation to obtain all necessary equipment and to design the facility. AJS has made down payments to secure the price and delivery schedule of the project's critical equipment.

(i) Status of Financing: AJS began seeking financing proposals in July 1988. Six institutions, all experienced in lending to the alternate energy industry, expressed serious interest in the project by responding with detailed proposals. AJS decided to proceed with Kansallis-Osake-Pankki and The Fuju Bank, Limited. These lenders completed their due diligence review and were, at the end of 1988, prepared to proceed with documentation and closing of the lending arrangements. (Exhibit 4, Attachment 1, Project Financing Letter.)

(j) Cash Flow Analysis: AJS provided PG&E with a pro forma cash flow statement. PG&E's evaluation of the pro forma, using standard financial investment tests, confirmed the economic viability of the facility.

(k) Developer's Prior Experience: AJS's parent company, Axel Johnson, Inc., is actively involved in the alternative energy industry. Axel Johnson, Inc. has two operational projects of its

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6. See: Exhibit 3, pp. 2-3.

own and 14 other projects which it holds jointly with another party.

DRA obtained and reviewed the documentation submitted to PG&E by AJS on project viability, including permitting information, letters of intent, pro forma cash flow and fuel supply analyses, and engineering agreements. In DRA's view, the information provided indicates a reasonable possibility that the project is viable under the original ISO4. (TR at 59.)

At the same time, DRA identifies some uncertainties related to project viability. Because the Aberdeen densification plant is the only fuel source identified for the AJS project, DRA notes that timely construction of that plant is as essential to the viability of the project as timely construction of the biomass project itself. For both construction projects, the letter of intent specifies that it is not a legally binding or enforceable agreement. DRA also notes that the First Amendment was executed 18 months before the original construction deadline. In DRA's view, this time allowance is "rather narrow", given AJS's estimated lead-time (16-18 months) needed for projects such as Soledad. (TR at 61-62.)

DRA also points out that the net return to owner shown in the cash flow statement contains sustained negative returns for the 5-year period beginning in year 6 of the project. Moreover, the fixed energy price period expires in year 10, which increases the risk surrounding the projected positive returns from that point forward. DRA acknowledges that it is not uncommon for financially viable projects to forecast some periods "in the red," as long as the project as a whole is viable. However, DRA considers this to



be an indicator of uncertainty regarding the economic viability of the project.<sup>7</sup>

**B. Benefits/Costs To Ratepayers**

Since the energy and capacity prices under ISO4 are higher than current projections of short-run avoided costs, ratepayers benefit from viable projects being deferred into the future. According to PG&E, the First Amendment saves ratepayers an estimated \$18 to \$25 million (net present value, in 1989 dollars). These savings result from the price concessions agreed upon by AJS, coupled with deferral of the project to a date when ISO4 prices will be closer to expected avoided costs.<sup>8</sup> They also take account of the lump sum deferral payment of \$3.7 million. The range in estimates reflect two sets of resource assumptions (PG&E's and DRA's).

DRA points out that these savings are realized only if one assumes that the project is viable under the unamended contract. If the project is not viable, but ultimately built under a five-year deferral, ratepayers experience net costs of \$16 to \$29 million. These figures reflect the estimated overpayments associated with the amended contract, including deferral payments.

Since PG&E has the option of reducing the deferral period under the First Amendment, DRA also examined net benefits/costs to ratepayers of two-, three-, and four-year deferrals. From this

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7 See Exhibit 7, p. 4. As described below, a late-filed exhibit was submitted with corrected cash flows; nonetheless, DRA's general observations concerning the direction of cash flows are still valid.

8 In other words, net benefits accrue to ratepayers to the extent that overpayments under the deferral agreement are less than the overpayments that would have been paid under the unamended contract. Overpayments are calculated as the difference between contract prices and current projections of short-run avoided costs.

analysis, DRA concludes that, based on current projections of avoided costs, the five-year deferral period maximizes ratepayers benefits (if the project is viable) and minimizes ratepayer costs (if the project is nonviable). DRA therefore doubts that implementing the option to reduce the deferral would ever be in the ratepayers' best interest. Figure 1 illustrates the range of estimated ratepayer savings/costs associated with the deferral options, depending on the status of project viability.<sup>9</sup>

**C. The Deferral Payment**

As described above, the First Amendment includes a deferral payment of \$3.7 million, \$2.9 million of which is paid upfront (30 days after the Commission's decision), with the remainder being paid (with interest) when the project begins energy deliveries. PG&E and AJS testified that the deferral payment was negotiated to compensate AJS for the costs of deferral, including nonrecoverable expenses for reengineering, permitting and other development activities needed to be redone. (TR at 31, 49-50.) According to PG&E, the \$3.7 million payment was arrived at as part of a negotiating process, after reviewing AJS's estimates of nonrecoverable expenses.<sup>10</sup>

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9 DRA also assessed the net benefits to ratepayers if the Commission denies this application, and the "backup" one-year nonpaid deferral (with pricing concessions) takes effect. This backup deferral is described in the October 28, 1988 Letter of Intent between PG&E and AJS, but is not included in the executed First Amendment. Should this deferral take place as a result of today's decision, it will be reviewed for reasonableness in the appropriate Energy Cost Adjustment Clause (ECAC) proceedings.

10 AJS originally submitted estimates of approximately \$5 million in nonrecoverable development costs, including \$2.25 million in bankruptcy payments. AJS is required to make these payments as a condition for assignment of the PPA. PG&E recognized only \$1.4

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In PG&E's view, the deferral payment is an integral part of the negotiated package, and AJS would not have agreed to a deferral without it. In support of this position, AJS testified to the various costs and risks it assumes under the First Amendment, including nonrecoverable expenses, loss of tax benefits, energy and capacity price concessions, and the uncertainty concerning future development costs. (TR at 31, 45-47, 53-54, 126-127.)

AJS also testified that, in certain respects, the deferral makes it easier to develop the project. (TR at 29, 55-57, 132.) However, AJS asserts that these considerations do not offset the costs/risks of deferral; they simply would have proceeded with the project, as planned, if PG&E had approached them with a nonpaid proposal (TR at 133).

In its testimony, DRA concluded that PG&E was reasonable in attempting to negotiate a paid deferral with AJS.<sup>11</sup> However,

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million of these costs as lost expenses attributable to the First Amendment. The final negotiated figure reflects PG&E's estimates of nonrecoverable costs, plus the bankruptcy payments. PG&E testified that it considered the bankruptcy expenses as a separate category from deferral-related expenses, to be negotiated separately. (See TR at 49-54, 106-108, 111-115.)

11 While DRA did not originally question the need to pay something for this deferral, DRA subsequently raised this issue during evidentiary hearings in sponsoring Exhibits 5 and 6. These exhibits compare the internal rates of return (IRRs) to AJS, on a cash flow basis, for the unamended and deferral agreements. They were developed from the pro forma cash flow information supplied by AJS in response to DRA's data requests. Exhibits 5 and 6 indicate that AJS would realize substantial cash flow benefits from the deferral. However, during the hearing process it became apparent that (a) the assumptions used in the cash flow projections were inconsistent with each other and included significant errors

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DRA questions the need for an upfront payment to realize the deferral benefits. DRA notes that, under a paid deferral (or buyout), ratepayers face both the risk of project nonviability, as well as an abandonment risk. Abandonment risk represents the added cost to ratepayers (the upfront payment) of deferring a project that was not viable to begin with. As long as there is some uncertainty regarding these risks, DRA believes that the deferral agreement should be structured to eliminate as much ratepayer risk as possible.

DRA argues that PG&E shareholders should share this risk. In DRA's view, giving PG&E an economic stake in the correctness of its own assessment of the viability of the project will help to ensure that PG&E has fully applied its substantial investigative resources to its review. DRA therefore recommends that PG&E be allowed to book in ECAC only 75% of the \$2.9 million upfront payments, with the remaining 25% to be recovered with the \$735,000 payment when the project comes on line.

## V. Discussion

As we emphasized in D.88-10-038, paid deferrals put the ratepayers at the greatest risk of any type of contract modification. The ratepayers are not only put at risk that the

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related to tax considerations and (b) the IRR could not be used as a comparison measure of profitability because there were negative cash flows. (See TR at 43, 94-95, 102-103, 108-111.) Accordingly, PG&E was directed to submit late-filed Exhibit 9 with corrected cash flow comparisons, using NPV analysis. This exhibit, which was reviewed and approved by DRA and AJS, indicates that projected cash flows are lower on a net present value basis under the First Amendment deferral.

agreement breathes life into a moribund project, but also that they are paying for something they would otherwise have received for free.<sup>12</sup> Accordingly, the viability test for paid deferrals is a stringent one.

We have carefully reviewed the record on the issue of viability, and concur with PG&E and DRA that the project has passed the threshold test outlined in our Guidelines. As described in Section IV above, as of October 28, 1988, when PG&E and AJS signed the deferral letter of intent, Soledad was well on track under all aspects of project development: The project was in full compliance with the QFMP milestones, and AJS had already obtained all necessary permits. On August 3, 1988, AJS signed a 10-year contract with a major lumber company for the supply of woodwaste fuel in a region with large stores of waste fuel available. On September 30, 1988, 21 months prior to the five-year deadline, AJS signed a letter of intent with construction contractors outlining terms with strong incentives for timely completion of the project. Major equipment had been ordered, and deposits had been placed on that equipment. Pro forma cash flow projections indicate that the project was financeable under the original contract. Lenders had completed their review of the project and were ready to proceed with documentation and closing of the lending arrangements.

Based on the impressive documentation of viability presented in this case, we are satisfied that PG&E was reasonable in approaching AJS to negotiate a paid deferral for the Soledad project. We agree with PG&E that, in all likelihood, the project could have come on-line under the unamended ISO4 contract.

This finding of reasonableness does not, however, automatically extend to the specific terms of the negotiated

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12 See D.88-10-038, pp. 33, 36.

deferral. The reasonableness of those terms depends upon several factors, including (1) the range of net ratepayer benefits/risks associated with the deferral, (2) the relative likelihood of ratepayers experiencing these benefits/costs, (3) the extent to which deferral benefits could be achieved without a deferral payment, and (4) the level and timing of the deferral payment. As discussed below, the issue of ratepayer risk must be factored into each of these considerations.

We start with the deferral payment. Clearly, ratepayers would be better off under all possible scenarios (see Figure 2) if they didn't have to pay \$3,675,000 for the deferral. Is this payment necessary? We address this question by examining the relative benefits and costs/risks to AJS in agreeing to a five-year deferral of Soledad.

In terms of benefits, AJS acknowledges that keeping the project in the company's portfolio for future development would enable top management to allocate more time to a recently acquired Synergics company. (TR at 29, 55-57.) In addition, AJS may avoid some bonus payments that it would have had to pay to the contractor to meet the 1990 deadline.<sup>13</sup> (TR at 132.) The deferral also benefits AJS to the extent that there is any residual uncertainty concerning project viability.

However, as summarized in Figure 2, the costs and risks to AJS are substantial: Estimates of nonrecoverable development costs, including equipment deposits, permit fees, testing, and

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<sup>13</sup> The First Amendment also provides AJS with some flexibility to relocate the plant within the same industrial park. In our view, this "benefit" directly offsets the risk to AJS that the parcel of land in the industrial park (for which AJS has been paying purchase options) will not be available in five years. In effect, these two elements of the benefit/cost comparison cancel each other out. (See Figure 2.)

reengineering, range from \$1.6 (PG&E) to \$2.9 million (AJS). The pricing concessions agreed to in the First Amendment represent payment reductions of \$1.4 to \$2.9 million (in NPV, 1989 dollars). The deferral also delays the revenues that AJS would use to offset upfront bankruptcy disbursements, required as a condition for assumption of the PPA from the previous developer. In addition, AJS assumes all risks that economic or regulatory factors might change to reduce project profitability. And finally, in deferring Soledad, AJS will lose certain tax benefits, as reflected in a somewhat lower cash flow and return to owner. (See Late-filed Exhibit 9.)

On balance, the record in this proceeding indicates that the costs and risks to AJS in deferring the project for five years far outweigh the potential benefits. We note that the issue of viability extends to this conclusion as well. If there were major uncertainties concerning project viability, the benefits of deferral to AJS could far outweigh the costs/risk. Given our assessment of viability, and the above comparison of benefits/costs to AJS, we conclude that a deferral payment is indeed necessary to gain the ratepayer benefits associated with the First Amendment deferral.

We now examine the relative benefits and costs to ratepayers of the negotiated package, including the deferral payment terms. Guideline III, paragraph 7, states that "on-line date deferrals...may be considered only if the ratepayers' interests will be served demonstrably better by such deferral." There is no controversy over the relevant range of estimates for potential ratepayer benefits under this paid deferral. These estimates are presented in Figure 1. PG&E and DRA agree that ratepayers would realize an estimated \$18 to \$25 million (in NPV), assuming that the project is viable. In fact, if the project is viable, ratepayers are even better off (\$31 to \$52 million) if the deferral is approved, but AJS later decides to abandon the project,

due to unforeseen future events. In other words, if the project is viable, then ratepayers are better off under the First Amendment deferral, regardless of whether or not the project is ultimately built.

As DRA points out, there is always some risk to ratepayers that the project is not viable. While we concur with PG&E that the deferral is most likely to benefit ratepayers (i.e., because it is most likely that the project was viable to begin with), DRA has identified some legitimate uncertainties regarding project viability. As a result, ratepayers are exposed to some risk of nonviability, and the associated negative outcomes outlined in Figure 1.

Ideally, we would assign specific probabilities to each of the potential outcomes of this agreement, and then derive a weighted average of projected ratepayer net benefits. Were the issue of viability a close call, we would probably need to carefully consider the likelihood of each event. However, as discussed above, we consider the most likely outcomes to be those associated with a viable project. While viability may not be 100% certain, in our judgment it is certainly close. Moreover, even under the most conservative assessment of what constitutes "most likely," ratepayer benefits are substantial.<sup>14</sup> We therefore conclude that the proposed paid deferral complies with Guideline III, paragraph 7. Ratepayers will be served demonstrably better by such deferral, even when the risks of nonviability are taken into account.

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14 For example, if the probability of the project being viable were assessed at only 51% (the lowest possible "most likely" figure), and the built/not built outcomes were given equal, 50% weighting, net benefits to ratepayers would be \$8 to \$12 million (in NPV).



PG&E and AJS would argue that these findings are sufficient for approving the reasonableness of the First Amendment terms, including the upfront payment of \$2.9 million. However, we agree with DRA that the deferral agreement should be structured to eliminate as much ratepayer risk as possible. In addition to the risk of nonviability, a paid deferral imposes the added risk of paying to defer a project (even a viable one) that the developer has already decided to abandon.<sup>15</sup> The cost to ratepayers of this risk is the upfront payment of \$2,940,000.

In our judgment, DRA's proposal to put ratepayers at risk for only 75% of this upfront payment is an appropriate restructuring to minimize ratepayer risk. However, we do not agree with DRA that PG&E's shareholders should be at risk for the remaining 25%. PG&E's ratepayers, and not the shareholders, benefit from reductions in contract overpayments. Moreover, ultimate completion of the project is not a measure of PG&E's aggressiveness in assessing project viability under the unamended contract. Since the allocation of benefits and costs in this deferral agreement are solely between ratepayers and the developer, our proposed restructuring of the upfront payment will affect only these two parties.

Accordingly, we approve the First Amendment subject to the following revised terms: AJS would receive \$2,205,000 (75% of \$2,940,000) upfront. We note that this revised upfront payment more than adequately covers the nonrecoverable development costs

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<sup>15</sup> During the hearings, there was some confusion over the meaning of this term. It does not refer to the ultimate abandonment of a project, due to future events (i.e., the "not built" outcomes in Figure 1). Rather, it refers to the downside risk that a developer, for a variety of reasons, may have already decided not to pursue the project, even if it could have been built under the original terms of the contract. (See TR at 96.)

attested to by PG&E. Upon approval of its reapplication for a critical path permit, AJS would receive an additional \$294,000, with interest at the three-month Commercial paper rate. The remaining \$1,176,000 (also with interest), would be paid when energy deliveries begin from the facility, as defined in the agreement. These payments would all be recoverable in PG&E's ECAC rates. In all other respects, the First Amendment terms would remain unchanged.

The ALJ's proposed decision would make the upfront payment fully refundable if the project was not ultimately brought on-line. In its comments, AJS argued that this approach is contrary to recently enacted Public Utilities Code § 2826, which requires cash upfront payments to be fully refundable for projects that do not have all of their permits. AJS argues that the new law exempts from this requirements projects, such as Soledad, for which all necessary permits have been received. We disagree. Although the law now requires refundability when some permits have not been received, it does not preclude us from extending similar requirements to other paid deferral arrangements. Nonetheless, we choose not to require such a refund arrangement here, because of the convincing showing as to project viability.

Thus, our order today is to deny the application, but we will hold the proceeding open, pending receipt of a status report from PG&E. The status report is due no later than 15 days from the effective date of this order. The report will indicate acceptance or rejection of the revised terms set forth above. In the case of acceptance, the report shall attach revised First Amendment language implementing these terms. If the revisions fully comply with the terms outlined above, the revisions would support a prospective finding that payments by PG&E pursuant to the First Amendment are reasonable and fully recoverable from ratepayers to the same extent as payments pursuant to standard offer power

purchase agreements.<sup>16</sup> Similarly, if the parties accept the suggested revisions pursuant to D.88-10-032 (Conclusion of Law 36), the facility's current Milestone No. 12 deadline under the QFMP would be extended to June 27, 1996.

Findings of Fact

1. AJS is the current developer of a 16 MW woodwaste facility located in Soledad, California.
2. Soledad's PPA reflects the terms and conditions of ISO4.
3. Under the terms of the PPA, Soledad is required to be operational by June 27, 1990.
4. Under the terms of the PPA, AJS would be paid fixed energy payments based on 100% of forecasted prices over the fixed price period (10 years). Capacity payments would be fixed and levelized at \$196/kW-year over the 30-year contract.
5. On October 28, 1988, PG&E and AJS signed a letter agreement outlining deferral terms for the Soledad project.
6. On December 29, 1988, PG&E and AJS executed the final deferral agreement, embodied in a First Amendment to the Soledad Power Purchase Agreement.
7. Under the First Amendment, AJS would: (a) defer the project on-line date for five years, except if a shorter deferral period were requested by PG&E; (b) reduce ISO4 energy payments to 90% of fixed, forecasted prices, with 10% based on published prices; (c) reduce ISO4 capacity payments to \$186/kW-year for the first 10 years of the contract; (d) receive \$2,940,000 upfront and \$735,000 (plus interest) when the project begins energy deliveries; and (e) have the option of submitting a new proof of site control, provided the project remains within the Soledad Industrial Park.

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<sup>16</sup> However, we will reserve the right to examine for reasonableness in the appropriate ECAC proceeding any decision by PG&E to shorten the deferral period under the First Amendment, or to invoke the backup one year nonpaid deferral.

8. On March 23, 1989, PG&E filed A.89-03-036 requesting ex parte approval of the First Amendment.

9. On June 7, 1989, DRA filed a limited protest.

10. A day of hearing was held on July 24, 1989 before Commissioner Eckert and ALJ Weissman.

11. The Commission's guidelines on contract administration (Guidelines), adopted in D.88-10-032, require examination of a QF's viability under the unamended contract as a prerequisite to modifications.

12. The Guidelines further state that, in general, deferrals and buyouts should be considered only with QFs who have obtained all of the permits and certification necessary to go forward with their projects.

13. The Guidelines state that on-line date deferrals may be considered only if the ratepayers' interests will be served demonstrably better by such deferral.

14. On August 3, 1988, AJS signed a 10-year contract with a major lumber company for the supply of woodwaste fuel in a region with large stores of waste fuel available.

15. On September 30, 1988, 21 months prior to the five-year deadline, AJS signed a letter of intent with construction contractors outlining terms with strong incentives for timely completion of the project.

16. As of October 28, 1988, when PG&E and AJS signed the deferral letter of intent, AJS had already (a) obtained all necessary permits to go forward with the Soledad project; (b) ordered and placed deposits on major equipment, and (c) solicited and received serious financing proposals from six major banks.

17. By the end of 1988, project lenders had completed their due diligence review of Soledad and were prepared to proceed with documentation and closing of the lending arrangements.

18. Pro forma cash flow projections indicate that the project was financeable under the original contract.

19. Soledad is in full compliance with the QFMP milestones.

20. AJS's parent company, Axel Johnson, Inc. is actively involved in the alternative energy industry.

21. DRA obtained and reviewed the documentation submitted to PG&E by AJS on project viability:

22. DRA concludes that Soledad meets the Commission's threshold test of viability, because there is a reasonable possibility that the project is viable under the original ISO4.

23. AJS's estimated leadtime for projects such as Soledad is 16-18 months.

24. Under the unamended contract, the net return to owner cash flow contains sustained negative returns for the five-year period beginning in year six of the project.

25. If the project is viable under the unamended contract, and ultimately built, the First Amendment saves ratepayers an estimated \$18 to \$25 million (NPV in 1988 dollars) in overpayments.

26. If the project is viable, but not built due to unforeseen future events, the First Amendment saves ratepayers an estimated \$31 to \$52 million in overpayments.

27. If the project is not viable, and ultimately built, the net costs to ratepayers under the First Amendment is estimated at \$16 to \$29 million.

28. If the project is not viable, but not built due to unforeseen future events, the net costs to ratepayers under the First Amendment is \$2.9 million.

29. Based on current projections of avoided costs, the five-year deferral period maximizes ratepayer benefits if the project is viable, and minimizes ratepayer costs if the project is nonviable.

30. Even under the most conservative estimate of what constitutes a reasonable probability (i.e., 51%) of viability, estimated net benefits to ratepayers of a five-year deferral are substantial.

31. Ratepayers would be better off under all possible scenarios if they did not need to pay the developer for this deferral.

32. Ratepayers should pay for a deferral only if the costs/risks to the developer appear to substantially outweigh the benefits of deferral.

33. Keeping the project in the company's portfolio for future development would enable AJS management to devote more time to a recently acquired Synergics Company.

34. The deferral may enable AJS to avoid some bonus payments to the construction contractor.

35. Estimates of nonrecoverable development costs, including equipment deposits, permit fees, testing, and reengineering range from \$1.6 (PG&E) to \$2.9 million (AJS).

36. The pricing concessions agreed to in the First Amendment represent payment reductions of \$1.4 to \$2.9 million (in NPV, 1989 dollars).

37. The deferral delays the revenues that AJS would use to offset upfront bankruptcy disbursements, required as a condition for assumption of the Purchase Power Agreement from the previous developer.

38. Under the First Amendment, AJS assumes all risks that economic or regulatory factors might change to reduce project profitability.

39. In deferring Soledad, AJS will lose certain tax benefits, as reflected in a somewhat lower cash flow and return to owner.

40. There is always some risk to ratepayers that the project is not viable.

41. In addition to the risk of nonviability, a paid deferral with upfront payments imposes the added risk of paying to defer a viable project that the developer has already decided to abandon.

42. DRA's proposal to put ratepayers at risk for only 75% of the \$2.9 million upfront payment restructures the First Amendment to minimize ratepayers' risks.

43. DRA's proposal for risk sharing would put PG&E shareholders at risk for the remaining portion of the upfront payment.

44. PG&E's ratepayers, and not shareholders, benefit from reductions in the overpayments associated with standard offers.

45. Completion of Soledad in five years is not a measure of PG&E's aggressiveness in assessing project viability under the unamended contract.

46. The allocation of benefits and costs/risks associated with the First Amendment is between ratepayers and the developer.

47. If the First Amendment is revised consistent with the foregoing discussion, payments by PG&E pursuant to such Amendment would be reasonable and recoverable from ratepayers as provided for in this order.

Conclusions of Law

1. PG&E has met the threshold test of project viability, consistent with our adopted guidelines in D.88-10-032, in negotiating a paid deferral with Soledad.

2. A deferral payment is necessary to gain the ratepayer benefits associated with the First Amendment deferral.

3. Under the most likely scenarios, ratepayers will derive substantial monetary benefits under the terms of the First Amendment, assuming a five-year deferral period.

4. The reasonableness of PG&E to exercise its option under the First Amendment for a shorter deferral should be reviewed in the appropriate ECAC proceeding.

5. Considering the various uncertainties, the proposed upfront payment is unreasonable because it does not adequately mitigate the downside risks to ratepayers, and exposes ratepayers to an unacceptable amount of development risk.

6. This order should be made effective immediately in order to give PG&E and AJS timely information regarding the status of the proposed First Amendment.

ORDER

IT IS ORDERED that:

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

2. PG&E shall file a status report on the revision of the First Amendment. The report shall be filed and served in this proceeding no later than 15 days from the effective date of this order, and shall indicate whether PG&E and Axel Johnson Soledad, Inc. accept or reject the revised terms described in Section V of the opinion. In the case of acceptance, the report shall attach revised First Amendment language implementing these terms.

This order is effective today.

Dated November 22, 1989, at San Francisco, California.

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

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

- 24 -

*Wesley Franklin*  
WESLEY FRANKLIN, Acting Executive Director  
*JB*



Figure 1  
Page 1

Comparison of Monetary Benefits to  
Developer/Ratepayer for Soledad Project

		<u>Outcome</u>	<u>Ratepayer Net Benefits</u>	<u>Payments to Developer</u>
		(\$ million, 1989 NPV)		
First Amendment (5-year Deferral)	<u>Viable</u>	<u>Built</u> (1)	(1) 17.8 - 25.2	80.1 - 96.7
		<u>Not Built</u> (2)	(2) 30.9 - 51.7	2.9
	<u>Not Viable</u>	<u>Built</u> (3)	(3) (16 - 29.4)	80.1 - 96.7
		<u>Not Built</u> (4)	(4) (2.9)	2.9

Figure 1  
Page 2

Ratepayer net benefits/costs under the First Amendment, assuming that Soledad comes on line before the 5-year deferral date (upon notice by PG&E) are:\*

- A. If the project is viable and ultimately built (outcome (1) above):

<u>Term of Deferral</u>	<u>Net Ratepayer Benefits (Net Reduction in Overpayments)</u>
2 years	\$ 7.2 to 10.7 million
3 years	\$10.4 to 15.6 million
4 years	\$14.4 to 20.9 million

- B. If the project is not viable, but ultimately built (outcome (3) above):

<u>Term of Deferral</u>	<u>Net Ratepayer Benefits (Net Reduction in Overpayments)</u>
2 years	\$26.5 to 43.8 million
3 years	\$23.4 to 38.9 million
4 years	\$19.4 to 33.7 million

\* Source: Exhibit 7, Appendix B, page 6.

Figure 1\*  
Page 3

Notes to Figure 1

"Viable" refers to the likelihood that the project could have met contract obligations (and on-line requirements) under the unamended contract.

Net benefits (or costs) reflect any changes in overpayments under the contract, relative to the unamended contract. For a project that is viable to begin with, and subsequently built, net benefits are calculated as the difference between (1) the unamended contract payments less short-run avoided costs (SRAC) and (2) the deferral contract payments, including any upfront payments, less SRAC. If the project is not built under deferral contract terms, net benefits simply reflect (1) above, less any upfront deferral payments. This is because a viable project would have been built under the unamended contract; ratepayers actually avoid all of these overpayments if the project is later abandoned.

For a project that is not viable to begin with, the calculation of net benefits or costs is as follows: If that project is subsequently built (under deferral contract terms), ratepayers experience "net costs" equal to overpayments associated with the deferral contract, including any upfront payments. However, if the project is not built, then the only net costs ratepayers are any upfront deferral payments. This is because a non-viable project would have been abandoned anyway under the unamended contract. Under these circumstances, the deferral does not represent a change (increase or decrease) in contract overpayments.

- \* All figures are expressed in net present value (NPV), in millions of 1989 dollars. The ranges in estimates for net ratepayer benefits reflect the two sets of resource planning assumptions (for SRAC) provided in Exhibit 8. All figures for "payments to developer" are from Exhibit 8.

Figure 1  
Page 4

The calculations for net ratepayer benefits are presented below:

		<u>Energy</u>	<u>Capacity</u>	<u>Total</u>		
(A) Overpayments under unamended agreement:	(1)	40.6	13.95	54.55		
	(2)	24.6	9.19	33.79		
					<u>Deferral Payment</u>	<u>Total</u>
(B) Overpayments under paid deferral:	(1)	21.6	4.08	+ 3.7		29.38
	(2)	9.4	2.86	+ 3.7		15.96
(C) Upfront payment for paid deferral =						2.9

Net ratepayer benefits/costs under outcomes:

<u>Outcome</u>	<u>Calculation (see above)</u>
(1)	(A) - (B) = 17.83 - 25.17
(2)	(A) - (C) = 30.9 - 51.7
(3)	-(B) = (15.96 - 29.38)
(4)	-(C) = (2.9)

(END OF FIGURE 1)

Figure 2

Comparison of Costs and Benefits of Soledad  
Deferral to AJS (Without Deferral Payment)

<u>Benefits to Developer</u>	<u>Costs/Risks to Developer</u>
1. Adds flexibility to relocate plant within same industrial park. (TR at 45)	1. Costs estimated at \$1.6 to \$2.9 million (including nonrecoverable deposits and tests) for reengineering (e.g. steam turbine), permitting, and other development activities needed to be redone. (TR at 31, 49, 53-54)
2. Soledad kept in portfolio as future project while diverting limited management resources to Synergies project. (TR at 55)	2. Payment reductions of \$1.4 to \$2.9 million (in NPV, 1989 dollars) due to pricing concessions during first 10 years. (Exhibit 8)
3. Developer may avoid bonus payments to contractor for construction (and any uncertainty in meeting 5-year deadline). (TR at 132)	3. Risk that economic or regulatory factors might change to reduce profitability (e.g., construction costs, renewal of air quality permit, and associated requirements). (TR at 47, 53)
	4. Risk that the parcel of land in the industrial park (for which AJS has purchase options) is not available in 5 years. (TR at 46-47)
	5. Delay in revenues to cover upfront bankruptcy payment. (TR at 113-114)
	6. Lost tax benefits as reflected in lower NPV of cash flow and return to owner (even with deferral payment). (Exhibit 9)
	7. Change in public relations in Soledad area. (TR at 47)

## ATTACHMENT 1

1 FIRST AMENDMENT  
2 TO THE  
3 POWER PURCHASE AGREEMENT  
4 FOR  
5 LONG-TERM ENERGY AND CAPACITY  
6 BETWEEN  
7 AXEL JOHNSON SOLEDAD, INC.  
8 AND  
9 PACIFIC GAS AND ELECTRIC COMPANY

10 This First Amendment is by and between Pacific Gas  
11 and Electric Company ("PG&E"), a California corporation, and  
12 Axel Johnson Soledad, Inc. ("Seller"), a Delaware  
13 Corporation. PG&E and Seller are sometimes referred to  
14 herein collectively as the "parties" and individually as  
15 "party."

16 RECITALS

17 A. Oeberst & Associates on April 11, 1985, and  
18 PG&E on June 27, 1985, executed an Interim Standard Offer  
19 No. 4 Long-Term Energy and Capacity Power Purchase Agreement  
20 (the "Agreement") for a proposed 16,000 kW biomass facility  
21 to be located at Soledad Industrial Park, Monterey County,  
22 California (the "Facility"). The Agreement was thereafter  
23 assigned by Oeberst & Associates to Seller and acknowledged  
24 by the consent to assignment executed by PG&E on July 5,  
25 1988; and

26 B. Seller has provided documentation and other  
information requested by PG&E regarding the project status  
and the likelihood that Seller would build the Facility and

1 begin energy deliveries within the Agreement's Article 12  
2 five-year deadline. In particular, at PG&E's request,  
3 Seller has submitted information showing, among other  
4 things, that Seller has obtained all of the permits and  
5 certification necessary to go forward with construction and  
6 operation of the Facility and that fuel and construction  
7 financing are available. Seller has proven site control,  
8 has provided a Project Description and Interconnection Study  
9 Request, has paid for a detailed interconnection study, and  
10 is in compliance with the Qualifying Facility Milestone  
11 Procedure. Seller has provided PG&E with a letter from  
12 Seller's turn-key engineering and construction contractor  
13 assuring that Seller would be able to complete the Facility  
14 and begin energy deliveries within the Agreement's Article  
15 12 five-year deadline; and

16 C. Seller has represented that the information  
17 and documentation it has submitted to PG&E to demonstrate  
18 the Facility's viability are true, correct, accurate and  
19 complete. PG&E has relied substantially upon these  
20 representations in determining that the Facility is viable  
21 and that Seller could construct the Facility described in  
22 this Agreement and begin energy deliveries within the  
23 Agreement's Article 12 five-year deadline; and

24 D. Based upon the information and documentation  
25 submitted by Seller, PG&E has determined that the Facility  
26 is viable and that Seller could construct the Facility and

1 begin energy deliveries within the Article 12 five-year  
2 deadline; and

3 E. A key factor in PG&E's assessment of project  
4 viability is the identity of Seller; and

5 F. Despite Seller's confidence that Seller could  
6 construct the Facility and start energy deliveries within  
7 the Agreement's Article 12 five-year deadline, Seller wishes  
8 to defer construction of the Facility because, among other  
9 benefits, Seller could thereby avoid paying a substantial  
10 bonus to its turn-key engineering and construction  
11 contractor, and could make more efficient use of its  
12 economic and physical resources; and

13 G. PG&E wishes to defer the start of energy  
14 deliveries from the Facility in order to avoid in the  
15 interim paying for the Facility's energy at prices higher  
16 than the forecasted alternative replacement energy cost, and  
17 to defer the operation of the Facility until a time when  
18 there is a greater likelihood that PG&E will need the  
19 Facility's capacity. The deferral of the project is  
20 expected to result in substantial ratepayer savings; and

21 H. PG&E and Seller have agreed that energy  
22 deliveries will not begin earlier than March 1, 1995, and  
23 that the Agreement's fixed prices will not be paid for any  
24 deliveries from the Facility which occur prior to June 27,  
25 1995. If deliveries begin on or after March 1, 1995 and  
26 before June 27, 1995, Seller will receive nonfirm, economy



1 energy prices (which may be less than Standard Offer No. 1  
2 published energy prices), but no capacity prices prior to  
3 June 27, 1995; and

4 I. PG&E and Seller have agreed that under  
5 Article 12, initial energy deliveries from the Facility will  
6 occur no later than June 27, 1996; and that this represents  
7 a contractual obligation by Seller for the Facility which  
8 Seller may not breach in order to, among other things, take  
9 advantage of higher prices which may be available in the  
10 future; and

11 J. PG&E and Seller have agreed that during the  
12 fixed price period which shall not begin prior to June 27,  
13 1995, ninety (90) percent of Seller's deliveries shall  
14 receive fixed prices from Table B-1 of the Agreement, and  
15 ten (10) percent shall receive prices based upon PG&E's full  
16 short-term operating costs. The forecasted weighted annual  
17 average energy price in Table B-1 shall be 13.14¢/kwh from  
18 1997 through the end of the fixed price period; and

19 K. PG&E and Seller have agreed that the firm  
20 capacity price in the firm capacity price schedule shall be  
21 fixed at the price applicable for a firm capacity  
22 availability date of 1990, less \$10/KW, for the first 120  
23 months following the Facility's actual firm capacity  
24 availability date. Thereafter Seller shall receive the full  
25 price applicable for a firm capacity availability date of  
26 1990 for a 30-year term of agreement, this results in a firm

1 capacity price of \$186/kw-yr for the first 120 months, and  
2 \$196/kw-year thereafter; and

3 L. PG&E and Seller have agreed that for  
4 as-delivered capacity delivered in excess of firm capacity,  
5 the Seller will be paid under As-delivered Capacity Payment  
6 Option 2, as now specified in the Agreement, except that the  
7 forecast shortage cost in Table D-2 will be fixed at  
8 \$188/kw-yr from 1997, through the end of the term of  
9 agreement; and

10 M. PG&E and Seller have agreed that PG&E will  
11 make a deferral payment of \$3,675,000, which represents a  
12 portion of the reasonable costs incurred by Seller directly  
13 on development of the Facility as of October 24, 1988 for  
14 items that (a) will be lost or no longer used as a direct  
15 result of the deferral, including Investment Tax Credits,  
16 and (b) are not resalable ("Deferral Payment"). Eighty  
17 percent of the total Deferral Payment (\$2,940,000) will be  
18 paid within thirty (30) days after a decision by the CPUC  
19 approving this amended Agreement and unconditionally  
20 authorizing concurrent recovery in rates of all payments  
21 made under the amended Agreement, as provided in Recital O,  
22 becomes final, unconditional and unappealable (including  
23 exhaustion of all administrative or judicial appeals or  
24 remedies, and time periods thereof). The remaining 20  
25 percent (\$735,000), with interest at the three-month  
26 Commercial Paper rate for the previous month published in

1 the Federal Reserve Statistical Release, G.13, will be paid  
2 when energy deliveries begin from the Facility defined in  
3 the Agreement. The interest shall begin to accrue on the  
4 date that the CPUC's decision approving the amended  
5 Agreement, as provided in Recital O, becomes final,  
6 unconditional and unappealable; and

7 N. PG&E and Seller have agreed that PG&E will  
8 accept new proof of site control for the Facility on the  
9 condition that first, the new proof of site control is for a  
10 site entirely within the current boundaries of the "Soledad  
11 Industrial Park, Monterey County, California," which is the  
12 site specified in Article 3(b) of the unamended Agreement;  
13 and second, that Seller provide the new proof of site  
14 control to PG&E within eighteen (18) months prior to the  
15 date of initial energy deliveries from the Facility; and

16 O. PG&E and Seller have agreed to condition this  
17 amendment to the Agreement upon (1) the issuance by  
18 January 1, 1989 of a final, unconditional and unappealable  
19 decision dismissing the lawsuit by Arthur J. Mitteldorf  
20 against the City of Soledad, Industrial Power Technology,  
21 and Axel Johnson Energy Development Company, Inc., Superior  
22 Court of Monterey County, No. 87493, with prejudice, and  
23 (2) a final, unconditional and unappealable decision by the  
24 CPUC approving the reasonableness of the deferral agreement  
25 and unconditionally authorizing recovery in PG&E's rates of

26 ///

## ATTACHMENT 1

1 all payments made under this amended Agreement at the time  
2 the payments are made; and

3 P. PG&E and Seller have agreed that should PG&E  
4 determine that it needs the Facility's energy or capacity  
5 prior to June 27, 1995, PG&E may require that the Facility  
6 become operational prior to June 27, 1995, provided PG&E  
7 gives Seller written notice two years prior to the required  
8 operation date; and

9 THEREFORE, for the mutual promises and obligations  
10 stated herein, Seller and PG&E hereby agree to amend the  
11 Agreement (the "First Amendment") as follows:

12 1. Definitions

13 1.1 All underlined terms shall have the meaning  
14 stated in Section A-1 DEFINITIONS, Appendix A, pages A-2 to  
15 A-7 of the Agreement, except as expressly amended by this  
16 First Amendment.

17 1.2 Amend the definition of "fixed price period"  
18 in Appendix A, page A-4, lines 4 to 12, to read in its  
19 entirety as follows:

20 Fixed price period -- The period during  
21 which forecasted and levelized energy  
22 prices, and/or forecasted as-delivered  
23 capacity prices, are in effect; defined  
24 as the ten-year period beginning on the  
later of either the date of initial en-  
ergy deliveries or June 27, 1995, except  
as otherwise provided in Article 13.

25 1.3 Amend the definition of "firm capacity  
26 availability date" in Appendix A, page A-3, line 21, by

1 adding the following new sentence at the end of the  
2 definition:

3 In no event shall the firm capacity  
4 availability date occur prior to  
5 June 27, 1995, except as otherwise pro-  
vided in Article 13.

6 1.4 Amend the definition of "firm capacity price"  
7 in Appendix A, page A-3, line 26 by deleting the period  
8 (".") and by adding the following phrase:

9 , less \$10/KW for the first 120 months  
10 following the Facility's firm capacity  
11 availability date.

12 1.5 Add a new definition of "non-firm, economy  
13 energy purchases" in Appendix A, page A-7, line 10 as  
follows:

14 Nonfirm, economy energy purchases -- The  
15 lesser of (1) the price paid for energy,  
16 on an as-available basis, from third  
17 party suppliers, and (2) the cost of  
18 incremental energy from PG&E's own gen-  
19 eration resources. PG&E shall notify  
20 Seller in advance of the nonfirm, econo-  
21 my energy price. The price identified  
22 in the notice shall remain in effect  
23 until PG&E issues a new notice specify-  
24 ing a new nonfirm, economy energy price.

25 2. New Proof Of Site Control

26 Amend Article 3 PURCHASE OF POWER, page 5, line  
12, by adding the following new sentence to the end of  
Article 3(b):

PG&E shall accept new proof of site  
control for a site entirely within the  
boundaries of the Soledad Industrial  
Park which exist as of the effective  
date of the First Amendment, provided

## ATTACHMENT 1

1 that Seller shall submit such new proof  
2 of site control within eighteen (18)  
3 months prior to the date of initial  
4 energy deliveries from the Facility.

5 3. Energy Price

6 3.1 Delete in its entirety the three paragraphs  
7 following the heading "Energy Payment Option 1 - Forecasted  
8 Energy Prices," Article 4 ENERGY PRICE, page 7, line 8  
9 through page 8, line 10, and substitute the following:

10 (i) Seller shall not begin energy  
11 deliveries prior to March 1, 1995, and  
12 PG&E shall have no obligation to accept  
13 or pay for energy deliveries prior to  
14 March 1, 1995. If Seller begins energy  
15 deliveries on or after March 1, 1995 but  
16 prior to June 27, 1995, Seller shall be  
17 paid at prices equal to those PG&E pays  
18 for nonfirm, economy energy purchases.

19 (ii) During the fixed price period,  
20 Seller shall be paid for energy delivered  
21 at prices equal to 90 percent of  
22 the prices set forth in Table B-1, Appendix  
23 B, plus 10 percent of PG&E's full  
24 short-run avoided operating costs.

25 (iii) For the remaining years of the  
26 term of agreement following the expiration  
of the fixed price period, Seller  
shall be paid for energy delivered at  
prices equal to PG&E's full short-run  
avoided operating costs.

3.2 Delete Table B-1, Forecasted Energy Price  
Schedule, at Appendix B, page B-2, and substitute "Amended  
Table B-1, Forecasted Energy Price Schedule," which is  
attached as Attachment 1 to this First Amendment and incorporated  
herein by this reference.

///

1                   4.   Firm Capacity Price

2                   Delete Table E-2, Firm Capacity Price Schedule, at  
3 Appendix E, page E-10, and substitute "Amended Table E-2,  
4 Firm Capacity Price Schedule," which is attached as  
5 Attachment 2 to this First Amendment and incorporated herein  
6 by this reference.

7                   5.   As-Delivered Capacity Price

8                   5.1 Amend Appendix D, AS-DELIVERED CAPACITY, by  
9 deleting page D-1, line 23, through page D-2, line 15, and  
10 by substituting the following:

11                   For the remaining years of the term of  
12 agreement, PG&E shall pay Seller for  
13 as-delivered capacity at the as-deliv-  
14 ered capacity prices that were paid Sel-  
15 ler in the last year of fixed price  
16 period.

17                   5.2 Delete Table D-2, Forecasted Shortage Cost  
18 Schedule, at Appendix D, page D-5, and substitute "Amended  
19 Table D-2, Forecasted Shortage Cost Schedule, which is  
20 attached as Attachment 3 to this First Amendment and  
21 incorporated herein by this reference.

22 ///

23 ///

24 ///

## ATTACHMENT 1

6. Construction Start Date

Amend the first sentences of Section (f) of Article 3, PURCHASE OF POWER, at page 6, lines 7 to 16, and footnote 1 at line 24, to read:

If Seller does not begin construction of its Facility by (Date) 1/, PG&E may re-allocate the existing capacity on PG&E's transmission and/or distribution system which would have been used to accommodate Seller's power deliveries to other uses.

1/ Seller shall provide this date in the project development schedule to be submitted no later than thirty (30) days after signing the Special Facilities Agreement for the Facility.

7. Deferral Of Start Of Operations

Amend Section (c) of Article 3, PURCHASE OF POWER, page 5, lines 14 to 17, in its entirety to read as follows:

Except as otherwise provided in Article 13, PG&E shall have no obligation to accept or pay for deliveries of capacity from the Facility prior to June 27, 1995, and PG&E shall have no obligation to accept or pay for deliveries of energy from the Facility prior to March 1, 1995.

8. Article 12 Five-Year Deadline

Amend Article 12, TERM OF AGREEMENT, at page 14, lines 6 to 10, in its entirety to read:

This Agreement shall be binding upon execution and remain in effect thereafter for 30 years from the firm capacity availability date; provided, however, that it shall terminate if energy deliv-



eries from the Facility do not start by June 27, 1996.

9. PG&E's Option To Require Facility's Operation Prior To June 27, 1995.

Add the following new Article 13, OPTION TO REQUIRE OPERATION PRIOR TO JUNE 27, 1995, at page 14, line 11:

ARTICLE 13 OPTION TO REQUIRE OPERATION PRIOR TO JUNE 27, 1995

Should PG&E in its sole discretion determine that it needs the Facility's energy or capacity prior to June 27, 1995 for any reason whatsoever, PG&E may at its option require that the Facility begin deliveries of energy and capacity prior to June 27, 1995, on the condition that PG&E give Seller written notice two years prior to the required operation date. If PG&E exercises this option, the required operation date specified in PG&E's written notice to Seller shall be substituted for "June 27, 1995" throughout this First Amendment. The terms and conditions of this First Amendment shall otherwise be unchanged.

10. Deferral Payment

PG&E shall pay Seller \$3,675,000 (the "Deferral Payment"). Eighty percent of the Deferral Payment (\$2,940,000) shall be paid within thirty days after the date that the CPUC decision approving this First Amendment, as required in Paragraph 12 below, becomes final, unconditional and unappealable (including exhaustion of all judicial or administrative appeals or remedies, and time periods thereof) ("Approval Date"). The remaining twenty percent of

1 the Deferral Payment (\$735,000), together with interest  
2 accruing monthly at the three-month Commercial Paper rate  
3 for the previous month as published in the Federal Reserve  
4 Statistical Release, G13, from the Approval Date, shall be  
5 paid within thirty days after the date that energy  
6 deliveries begin from the Facility in accordance with the  
7 Agreement as amended by this First Amendment. Should  
8 publication of the three-month Commercial Paper rate be  
9 discontinued, interest shall accrue at the interest rate of  
10 commercial paper which most closely approximates the  
11 discontinued three-month Commercial Paper rate and which is  
12 published in the Federal Reserve Statistical Release, G13,  
13 or its successor publication.

14 11. Accuracy Of Information And Documentation

15 Seller represents that the information and  
16 documentation which it submitted to PG&E to demonstrate the  
17 Facility's viability are true, correct, accurate and  
18 complete.

19 12. Conditions And Regulatory Review

20 12.1 This First Amendment is conditioned upon and  
21 shall not be effective until (a) the CPUC issues a decision  
22 that in terms satisfactory to PG&E approves the  
23 reasonableness of the First Amendment and the Agreement as  
24 so amended, and unconditionally authorizes full recovery in  
25 PG&E's rates of all payments made under the First Amendment  
26 and Agreement as so amended (including but not limited to

1 the Deferral Payment) at the time the payments are made; and  
2 (b) such CPUC decision becomes final, unconditional and  
3 unappealable (including exhaustion of all administrative and  
4 judicial appeals or remedies and time periods thereof).  
5 PG&E shall inform Seller of the date when this condition has  
6 been satisfied.

7 12.2 This First Amendment is also conditioned upon  
8 and shall not become effective unless (a) by January 1,  
9 1989, a decision is issued dismissing the lawsuit by  
10 Arthur J. Mitteldorf against the City of Soledad, Industrial  
11 Power Technology, Axel Johnson Energy Development Company,  
12 Inc., Superior Court of Monterey County, No. 87493, with  
13 prejudice, and (b) such decision becomes final,  
14 unconditional and unappealable within 180 days thereafter.

15 12.3 PG&E and Seller shall use their best efforts  
16 to support the reasonableness of the First Amendment, and  
17 the Agreement as amended, before any government authority of  
18 competent jurisdiction in a proceeding involving a review of  
19 the First Amendment or the Agreement for purposes of  
20 allowance or disallowance in rates charged by PG&E. Each  
21 party shall bear its own costs and expenses associated with  
22 seeking such approval. Seller shall cooperate with PG&E to  
23 provide to the CPUC all information necessary to demonstrate  
24 the viability of the Facility.

25 ///

26 ///

1           13. Effect On Agreement

2           Except as expressly modified by this First  
3 Amendment, the provisions of the Agreement shall remain  
4 unchanged.

5           14. Entire Agreement

6           The First Amendment constitutes the entire  
7 agreement of the parties with respect to the subject-matter  
8 thereof and supersedes any and all prior negotiations,  
9 correspondence, understandings and agreements between the  
10 parties respecting the subject-matter of this First  
11 Amendment.

12           15. Modification

13           This First Amendment may be further amended or  
14 modified only by a written instrument signed by the parties  
15 hereto.

16           16. Captions

17           Captions are included herein for ease of reference  
18 only. The captions are not intended to effect the meaning  
19 of the contents or scope of this First Amendment.

20           17. Choice Of Laws

21           This First Amendment shall be construed and  
22 interpreted in accordance with the laws of the State of  
23 California, excluding any choice of law rules that may  
24 direct the application of the laws of another jurisdiction.

25       ///

26       ///

1           18. Non-Waiver

2           Failure by either party hereto to enforce any  
3 right or obligation with respect to any matter arising in  
4 connection with this First Amendment shall not constitute a  
5 waiver as to that matter or any other matter.

6           19. Notices

7           Amend Article 9, NOTICES, at page 13, lines 8-9 to  
8 replace "Vice President - Electric Operations" with "Vice  
9 President - Power Generation."

10          20. Interpretation

11          This First Amendment is the result of negotiation.  
12 Moreover, each party has reviewed this Amendment, and has  
13 had full and adequate opportunity to obtain legal advice  
14 regarding this Amendment from the legal counsel of its  
15 choice. Accordingly, the rule of construction in Civil Code  
16 § 1654 to the effect that any ambiguity shall be resolved  
17 against the drafting party shall not be employed against  
18 either party in the interpretation of this Amendment.

19          21. Confidentiality

20          Seller and PG&E agree to keep, and agree that they  
21 shall cause their respective counsel, consultants and agents  
22 to keep, this First Amendment confidential except for  
23 purposes of financing, disclosures to the CPUC or its staff  
24 (including the Division of Ratepayer Advocates and its  
25 counsel) for purposes of fulfilling the parties' obligations  
26 under Paragraph 12 (Conditions and Regulatory Review) of

1 this First Amendment, to the California Energy Commission,  
2 or where either party is required by law to disclose it.

3 22. Counterparts

4 This First Amendment may be executed in two or  
5 more counterparts, each of which shall be deemed an original  
6 and all of which shall constitute one and the same  
7 instrument.

8 IN WITNESS WHEREOF, the parties hereto have caused  
9 this First Amendment to be executed by their duly authorized  
10 representatives, and it is effective as of the last date set  
11 forth below:

12 AXEL JOHNSON SOLEDAD, INC. PACIFIC GAS AND ELECTRIC COMPANY

13  
14 BY: *[Signature]*

15 NAME: Michael L. Leighton

16 TITLE: President

17 DATE

18 SIGNED: *December 29, 1988*

BY: *[Signature]*

NAME: ROBERT J. HAYWOOD

TITLE: Vice President

DATE

SIGNED: December 29, 1988. *WA*

19 NOTICE

20 ADDRESSES: 110 East 59th St.  
New York, NY 10022  
21 Attn: Michael L.  
Leighton

Pacific Gas and Electric  
Company  
Attn: Manager, QF Contracts  
77 Beale Street, 23rd Floor  
San Francisco, CA 94106

AMENDED TABLE B-1  
FORECASTED ENERGY PRICE SCHEDULE

Year of Energy Deliveries	Forecasted Energy Prices*, c/kwh						Weighted Annual Average
	Period A			Period B			
	On-Peak	Partial-Peak	Off-Peak	On-Peak	Partial-Peak	Off-Peak	
1983	5.36	5.12	4.94	5.44	5.31	5.19	5.18
1984	5.66	5.40	5.22	5.74	5.61	5.48	5.47
1985	5.75	5.48	5.30	5.83	5.69	5.56	5.55
1986	5.99	5.72	5.52	6.08	5.94	5.80	5.79
1987	6.38	6.08	5.88	6.47	6.32	6.17	6.16
1988	6.94	6.62	6.39	7.03	6.87	6.71	6.70
1989	7.60	7.25	7.00	7.70	7.53	7.35	7.34
1990	8.12	7.74	7.48	8.23	8.04	7.85	7.84
1991	8.64	8.24	7.96	8.75	8.56	8.35	8.34
1992	9.33	8.90	8.60	9.46	9.24	9.02	9.01
1993	10.10	9.63	9.30	10.23	10.00	9.76	9.75
1994	10.91	10.41	10.06	11.06	10.81	10.55	10.54
1995	10.61	10.13	9.78	10.76	10.51	10.26	10.25
1996	10.40	10.88	10.51	11.57	11.30	11.03	11.02
1997	13.61	12.98	12.54	13.79	13.48	13.15	13.14
1998	13.61	12.98	12.54	13.79	13.48	13.15	13.14
1999	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2000	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2001	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2002	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2003	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2004	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2005	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2006	13.61	12.98	12.54	13.79	13.48	13.15	13.14

\* These prices are differentiated by the time periods as defined in Table B-4 and subsequently amended by the CPUC.

AMENDED TABLE E-2  
FIRM CAPACITY PRICE SCHEDULE

FIRM CAPACITY AVAILABILITY DATE	Number of Years of Firm Capacity Delivery																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	20	25	30
(Year)																		
1988	102	106	109	113	116	119	122	125	128	131	134	137	140	142	145	156	165	172
1989	110	114	117	121	124	128	131	134	137	141	144	147	149	152	155	167	176	184
1990	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1991	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1992	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1993	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1994	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1995	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1996	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196



ATTACHMENT 3

## AMENDED TABLE D-2

FORECASTED SHORTAGE COST SCHEDULE

<u>Year</u>	<u>Forecast Shortage Cost, \$/KW-Year</u>
1995	164
1996	176
1997	188
1998	188
1999	188
2000	188
2001	188
2002	188
2003	188
2004	188
2005	188
2006	188

Decision \_\_\_\_\_

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for an order approving the First Amendment to the Power Purchase Agreement for long-term energy and capacity between Axel Johnson Soledad, Inc. and Pacific Gas and Electric Company Inc. regarding deferral of the purchase of long-term capacity and energy from the Soledad Ecology No. 1 biomass facility.

Application 89-03-036  
(Filed March 23, 1989)

U-39-E

Roger J. Peters and Kathleen B. Welsh,  
Attorneys at Law, for Pacific Gas  
and Electric Company, applicant.  
Messrs. Graham & James, by Martin A. Mattes,  
Peter W. Hanschen, and Diane I. Fellman,  
Attorneys at Law, for Axel Johnson  
Energy Development, Inc. and Axel Johnson  
Soledad, Inc., interested party.  
Hallie Yacknin, Attorney at Law, and Perry L.  
Rice, for the Division of Ratepayer Advocates.

OPINION

I. Summary

Pacific Gas and Electric Company (PG&E) and Axel Johnson Soledad, Inc. (AJS) have entered into an agreement to defer the on-line date of AJS's qualifying facility (QF) project. Under the agreement, AJS would be paid \$3.7 million total (\$2.9 million upfront) to defer the project for up to five years. By this application, PG&E seeks our approval of the agreement and prospective finding that PG&E's payments are reasonable and recoverable in rates.

We decline to find reasonable the terms of the agreement as presently before us, but we describe a variant of the settlement that we would find reasonable.

## II. Background

In 1985, PG&E entered into a Purchase Power Agreement (PPA) with a developer named Oeberst & Associates to purchase electricity from a 16 megawatt woodwaste facility located in Soledad, California (Soledad). Under the terms of the PPA, Soledad was required to be operational by June 27, 1990. In 1988, PG&E agreed to an assignment of the PPA to AJS.

Soledad's PPA reflected the terms and conditions of Interim Standard Offer 4 (ISO4). ISO4 provides for fixed payment rates over long time spans. There are three energy payment options and two capacity options. Each provides for pricing certainty in the form of fixed prices (ramped or levelized), based on forecasts agreed to at a 1983 negotiating conference among utilities, QFs, and Commission staff.<sup>1</sup>

For energy payments, the Soledad developer chose Energy Option 1, which provides for fixed energy prices equal to 100% of the forecasted price over a 10-year fixed price period. At the end of the fixed price period, energy payments are based on published avoided energy costs, which are updated every quarter. In addition, the developer chose Capacity Option 2, for projects providing firm capacity, and for which payments are based on fixed, levelized shortage costs. If Soledad starts firm operations in 1990, as planned, it would receive fixed capacity payments of \$196/kw-year over the 30-year contract.

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<sup>1</sup> See D.83-09-054 on the development and payment terms of ISO4.

On June 8, 1988, the Commission issued an Order Instituting Rulemaking (R.88-06-007) requesting written comments on a proposed set of guidelines for negotiating modifications to standard offer contracts (Guidelines), including paid and nonpaid deferrals. In late summer, 1988, PG&E approached AJS to explore the possibility of negotiating a deferral for Soledad. On October 14, 1989, the Commission issued Decision (D.) 88-10-032 adopting final guidelines for these types of negotiations. On October 28, 1988, PG&E and AJS signed a letter agreement outlining the deferral. The final agreement, embodied in a First Amendment to the PPA, was executed on December 29, 1988. (See Attachment 1.)

On March 23, 1989, PG&E filed Application (A.) 89-03-036 requesting ex parte approval of the First Amendment. The Division of Ratepayer Advocates (DRA) filed a limited protest on June 7, 1989.<sup>2</sup> A day of hearing was held on July 24, 1989 before Commissioner Eckert and ALJ Weissman. Counsel for DRA, PG&E, and AJS presented closing arguments, in lieu of written briefs, at the July 24 hearing.

### III. The First Amendment

Under the First Amendment, PG&E would pay AJS to defer the Soledad project for up to five years.<sup>3</sup> PG&E would have the

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<sup>2</sup> By Administrative Law Judge (ALJ) ruling dated May 12, 1989, DRA was granted a six-week extension of the normal 30-day deadline for filing.

<sup>3</sup> Under the First Amendment, the earliest Soledad could begin to receive ISO4 capacity and energy prices is June 27, 1995, five years after the original deadline. Energy deliveries could begin as early as March 1, 1995, but payment would be at non-firm, economy/energy prices, with no payment for capacity. The latest

(Footnote continues on next page)

option of requiring AJS to shorten the deferral period upon two years' written notice. PG&E would pay AJS a lump sum deferral payment of \$3,675,000 structured as follows: (1) \$2,940,000 within 30 days of a final Commission decision approving the agreement and (2) \$735,000 plus interest when the project begins energy deliveries to PG&E.

The First Amendment also provides that ISO4 energy payments would be reduced from 100% of the fixed, forecasted prices to 90% forecasted and 10% published prices over the fixed price period. For the first 10 years of the contract, capacity payments would be reduced to \$186/kW-year, \$10/kW-year less than the amount to which AJS would be entitled if firm capacity availability were established in 1990.

Finally, the First Amendment provides AJS with an option to submit a new proof of site control, provided the project remains entirely within the current boundaries of the Soledad Industrial Park.

#### IV. Position Of The Parties

The testimony in this proceeding focused on three issues related to the reasonableness of the First Amendment: (1) project viability, (2) benefits/risks to ratepayers, and (3) the lump sum deferral payment. The positions of the parties are presented, issue-by-issue, below:

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(Footnote continued from previous page)

date at which initial energy deliveries could begin is June 27, 1996.

A. Project Viability

The Guidelines adopted by the Commission in D.88-10-032 require examination of a QF's viability under the unamended contract as a prerequisite to modifications. The Guidelines include a list of various aspects of project development that should be considered in assessing a project's viability. (See Attachment 2.) The Guidelines further state that, in general, deferrals and buyouts should be considered only with QFs who have obtained all of the permits and certifications necessary to go forward with their projects.<sup>4</sup>

In PG&E's view, the proposed deferral fully satisfies the requirement of the Commission's Guidelines that a deferred project be viable. In support of this position, PG&E and AJS presented the following information on various aspects of the project's development:<sup>5</sup>

(a) Project Description and Interconnection Study Cost Request Form: A completed form was submitted to PG&E on April 12, 1985.

(b) Proof of Site Control: Proof of site control in the form of land option payments was provided on August 29, 1985. (TR at 45.)

(c) Detailed Interconnection Study: A detailed interconnection study has been completed and a Special Facilities Agreement requested.

(d) Project Fee, Interconnection Priority: PG&E received proof that an escrow account had been established for the project fee on July 31, 1985. Interconnection priority was established on August 29, 1985, when proof of site control was

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4 D.88-10-032, Appendix A, Guideline 6.

5 Except as otherwise indicated, this information is directly from Exhibit 1, Prepared Testimony of Daniel Mesfin of PG&E.

submitted. The project is currently in compliance with the QF Milestone Procedure (QFMP).

(e) Permits: All major permits necessary to proceed with the project have been issued. The critical path permit, the Authority to Construct, was issued by the Monterey Bay Unified Air Pollution Control District on September 30, 1988. The other major permit, the Conditional Use Permit, was issued by the City of Soledad on July 20, 1988. (Copies of permits are attached to Exhibit 3.)

(f) Fuel Supply: AJS has concluded negotiations with Weyerhaeuser Corporation for a 10-year supply of woodwaste and a site for a woodwaste processing and cubing facility in Aberdeen, Washington. In addition, AJS initiated a long-term rail transportation agreement with Burlington Northern and Southern Pacific railroad companies as an optional fuel transportation mode. (Application, Exhibit E.)

(g) Feasibility of Construction By the Five-Year Deadline: The PPA five-year deadline for the Soledad project is June 27, 1990. Construction of both the Soledad facility and the Aberdeen fuel densification plant was to be by turnkey contract. AJS signed a letter of intent on September 30, 1988 with Ultrasystems Engineers and Constructors, Inc., and Energy Products of Idaho to construct the Soledad facility and Aberdeen fuel densification plant. The Letter of Intent describes the primary terms and conditions for turnkey construction of the facility and binds the parties to negotiate in good faith to a final contract. This document included a fixed price for the design, engineering, and construction of the facility, including the equipment purchasing, performance and completion guarantees, liquidated damages, and bonus clauses. Under the Letter of Intent, the

contractors would face severe penalties for failure to have the facility operational by the five-year deadline.<sup>6</sup>

(h) Equipment Procurement Status, Engineering, and Design Status: Under the turnkey contract described above, the contractors' obligation to have the facility operational by the five-year deadline included the obligation to obtain all necessary equipment and to design the facility. AJS has made down payments to secure the price and delivery schedule of the project's critical equipment.

(i) Status of Financing: AJS began seeking financing proposals in July 1988. Six institutions, all experienced in lending to the alternate energy industry, expressed serious interest in the project by responding with detailed proposals. AJS decided to proceed with Kansallis-Osake-Pankki and The Fuku Bank, Limited. These lenders completed their due diligence review and were, at the end of 1988, prepared to proceed with documentation and closing of the lending arrangements. (Exhibit 4, Attachment 1, Project Financing Letter.)

(j) Cash Flow Analysis: AJS provided PG&E with a pro forma cash flow statement. PG&E's evaluation of the pro forma, using standard financial investment tests, confirmed the economic viability of the facility.

(k) Developer's Prior Experience: AJS's parent company, Axel Johnson, Inc., is actively involved in the alternative energy industry. Axel Johnson, Inc. has two operational projects of its own and 14 other projects which it holds jointly with another party.

DRA obtained and reviewed the documentation submitted to PG&E by AJS on project viability, including permitting information,

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<sup>6</sup> See: Exhibit 3, pp. 2-3.



letters of intent, pro forma cash flow and fuel supply analyses, and engineering agreements. In DRA's view, the information provided indicates a reasonable possibility that the project is viable under the original ISO4. (TR at 59.)

At the same time, DRA identifies some uncertainties related to project viability. Because the Aberdeen densification plant is the only fuel source identified for the AJS project, DRA notes that timely construction of that plant is as essential to the viability of the project as timely construction of the biomass project itself. For both construction projects, the letter of intent specifies that it is not a legally binding or enforceable agreement. DRA also notes that the First Amendment was executed 18 months before the original construction deadline. In DRA's view, this time allowance is "rather narrow", given AJS's estimated lead-time (16-18 months) needed for projects such as Soledad. (TR at 61-62.)

DRA also points out that the net return to owner cash flow contains sustained negative returns for the 5-year period beginning in year 6 of the project. Moreover, the fixed energy price period expires in year 10, which increases the risk surrounding the projected positive returns from that point forward. DRA acknowledges that it is not uncommon for financially viable projects to forecast some periods "in the red," as long as the project as a whole is viable. However, DRA considers this to be an indicator of uncertainty regarding the economic viability of the project.<sup>7</sup>

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<sup>7</sup> See Exhibit 7, p. 4. As described below, a late-filed exhibit was submitted with corrected cash flows; nonetheless, DRA's general observations concerning the direction of cash flows are still valid.

**B. Benefits/Costs To Ratepayers**

Since the energy and capacity prices under ISO4 are higher than current projections of short-run avoided costs, ratepayers benefit from viable projects being deferred into the future. According to PG&E, the First Amendment saves ratepayers an estimated \$18 to \$25 million (net present value, in 1988 dollars). These savings result from the price concessions agreed upon by AJS, coupled with deferral of the project to a date when ISO4 prices will be closer to expected avoided costs.<sup>8</sup> They also take account of the lump sum deferral payment of \$3.7 million. The range in estimates reflect two sets of resource assumptions (PG&E's and DRA's).

DRA points out that these savings are realized only if one assumes that the project is viable under the unamended contract. If the project is not viable, but ultimately built under a five-year deferral, ratepayers experience net costs of \$16 to \$29 million. These figures reflect the estimated overpayments associated with the amended contract, including deferral payments.

Since PG&E has the option of reducing the deferral period under the First Amendment, DRA also examined net benefits/costs to ratepayers of two-, three-, and four-year deferrals. From this analysis, DRA concludes that, based on current projections of avoided costs, the five-year deferral period maximizes ratepayers benefits (if the project is viable) and minimizes ratepayer costs (if the project is nonviable). DRA therefore doubts that

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<sup>8</sup> In other words, net benefits accrue to ratepayers to the extent that overpayments under the deferral agreement are less than the overpayments that would have been paid under the unamended contract. Overpayments are calculated as the difference between contract prices and current projections of short-run avoided costs.

implementing the option to reduce the deferral would ever be in the ratepayers' best interest.<sup>9</sup>

C. The Deferral Payment

As described above, the First Amendment includes a deferral payment of \$3.7 million, \$2.9 million of which is paid upfront (30 days after the Commission's decision), with the remainder being paid (with interest) when the project begins energy deliveries. PG&E and AJS testified that the deferral payment was negotiated to compensate AJS for the costs of deferral, including nonrecoverable expenses for reengineering, permitting and other development activities needed to be redone. (TR at 31, 49-50.) According to PG&E, the \$3.7 million payment was arrived at as part of a negotiating process, after reviewing AJS's estimates of nonrecoverable expenses.<sup>10</sup>

In PG&E's view, the deferral payment is an integral part of the negotiated package, and AJS would not have agreed to a deferral without it. In support of this position, AJS testified to

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9 DRA also assessed the net benefits to ratepayers if the Commission denies this application, and the "backup" one-year nonpaid deferral (with pricing concessions) takes effect. This backup deferral is described in the October 28, 1988 Letter of Intent between PG&E and AJS, but is not included in the executed First Amendment. Should this deferral take place as a result of today's decision, it will be reviewed for reasonableness in the appropriate Energy Cost Adjustment Clause (ECAC) proceedings.

10 AJS originally submitted estimates of approximately \$5 million in nonrecoverable development costs, including \$2.25 million in bankruptcy payments. AJS is required to make these payments as a condition for assignment of the PPA. PG&E recognized only \$1.4 million of these costs as lost expenses attributable to the First Amendment. The final negotiated figure reflects PG&E's estimates of nonrecoverable costs, plus the bankruptcy payments. PG&E testified that it considered the bankruptcy expenses as a separate category from deferral-related expenses, to be negotiated separately. (See TR at 49-54, 106-108, 111-115.)

the various costs and risks it assumes under the First Amendment, including nonrecoverable expenses, loss of tax benefits, energy and capacity price concessions, and the uncertainty concerning future development costs. (TR at 31, 45-47, 53-54, 126-127.)

AJS also testified that, in certain respects, the deferral makes it easier to develop the project. (TR at 29, 55-57, 132.) However, AJS asserts that these considerations do not offset the costs/risks of deferral; they simply would have proceeded with the project, as planned, if PG&E had approached them with a nonpaid proposal (TR at 133).

In its testimony, DRA concluded that PG&E was reasonable in attempting to negotiate a paid deferral with AJS.<sup>11</sup> However, DRA questions the need for an upfront payment to realize the deferral benefits. DRA notes that, under a paid deferral (or buyout), ratepayers face both the risk of project nonviability, as well as an abandonment risk. As long as there is some uncertainty regarding these risks, DRA believes that the deferral agreement

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<sup>11</sup> While DRA did not originally question the need to pay something for this deferral, DRA subsequently raised this issue during evidentiary hearings in sponsoring Exhibits 5 and 6. These exhibits compare the internal rates of return (IRRs) to AJS, on a cash flow basis, for the unamended and deferral agreements. They were developed from the pro forma cash flow information supplied by AJS in response to DRA's data requests. Exhibits 5 and 6 indicate that AJS would realize substantial cash flow benefits from the deferral. However, during the hearing process it became apparent that (a) the assumptions used in the cash flow projections were inconsistent with each other and included significant errors related to tax considerations and (b) the IRR could not be used as a comparison measure of profitability because there were negative cash flows. (See TR at 43, 94-95, 102-103, 108-111.) Accordingly, PG&E was directed to submit late-filed Exhibit 9 with corrected cash flow comparisons, using NPV analysis. This exhibit, which was reviewed and approved by DRA and AJS, indicates that projected cash flows are lower on a net present value basis under the First Amendment deferral.

should be structured to eliminate as much ratepayer risk as possible.

DRA argues that PG&E shareholders should share this risk. In DRA's view, giving PG&E an economic stake in the correctness of its own assessment of the viability of the project will help to ensure that PG&E has fully applied its substantial investigative resources to its review. DRA therefore recommends that PG&E be allowed to book in ECAC only 75% of the \$2.9 million upfront payments, with the remaining 25% to be recovered with the \$735,000 payment when the project comes on line.

#### V. Discussion

As we emphasized in D.88-10-038, paid deferrals put the ratepayers at the greatest risk of any type of contract modification. The ratepayers are not only put at risk that the agreement breathes life into a moribund project, but also that they are paying for something they would otherwise have received for free.<sup>12</sup> Accordingly, the viability test for paid deferrals is a stringent one.

We have carefully reviewed the record on the issue of viability, and concur with PG&E and DRA that the project has passed the threshold test outlined in our Guidelines. As described in Section IV above, as of October 28, 1988, when PG&E and AJS signed the deferral letter of intent, Soledad was well on track under all aspects of project development: The project was in full compliance with the QFMP milestones, and AJS had already obtained all necessary permits. On August 3, 1988, AJS signed a 10-year contract with a major lumber company for the supply of woodwaste

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<sup>12</sup> See D.88-10-038, pp. 33, 36.

fuel in a region with large stores of waste fuel available. On September 30, 1988, 21 months prior to the five-year deadline, AJS signed a letter of intent with construction contractors outlining terms with strong incentives for timely completion of the project. Major equipment had been ordered, and deposits had been placed on that equipment. Pro forma cash flow projections indicate that the project was financeable under the original contract. Lenders had completed their review of the project and were ready to proceed with documentation and closing of the lending arrangements.

Based on the impressive documentation of viability presented in this case, we are satisfied that PG&E was reasonable in approaching AJS to negotiate a paid deferral for the Soledad project. We agree with PG&E that, in all likelihood, the project could have come on-line under the unamended ISO4 contract.

This finding of reasonableness does not, however, automatically extend to the specific terms of the negotiated deferral. The reasonableness of those terms depends upon several factors, including (1) the range of net ratepayer benefits/risks associated with the deferral, (2) the relative likelihood of ratepayers experiencing these benefits/costs, (3) the extent to which deferral benefits could be achieved without a deferral payment, and (4) the level and timing of the deferral payment. As discussed below, the issue of ratepayer risk must be factored into each of these considerations.

We start with the deferral payment. Clearly, ratepayers would be better off if they didn't have to pay \$3,675,000 for the deferral. Is this payment necessary? We address this question by examining the relative benefits and costs/risks to AJS in agreeing to a five-year deferral of Soledad.

In terms of benefits, AJS acknowledges that keeping the project in the company's portfolio for future development would enable top management to allocate more time to a recently acquired

Synergics company. (TR at 29, 55-57.) In addition, AJS may avoid some bonus payments that it would have had to pay to the contractor to meet the 1990 deadline.<sup>13</sup> (TR at 132.) The deferral also benefits AJS to the extent that there is any residual uncertainty concerning project viability.

However, as summarized in Figure 1, the costs and risks to AJS are substantial: Estimates of nonrecoverable development costs, including equipment deposits, permit fees, testing, and reengineering, range from \$1.6 (PG&E) to \$2.9 million (AJS). The pricing concessions agreed to in the First Amendment represent payment reductions of \$1.4 to \$2.9 million (in NPV, 1989 dollars). The deferral also delays the revenues that AJS would use to offset upfront bankruptcy disbursements, required as a condition for assumption of the PPA from the previous developer. In addition, AJS assumes all risks that economic or regulatory factors might change to reduce project profitability. And finally, in deferring Soledad, AJS will lose certain tax benefits, as reflected in a somewhat lower cash flow and return to owner. (See Late-filed Exhibit 9.)

On balance, the record in this proceeding indicates that the costs and risks to AJS in deferring the project for five years far outweigh the potential benefits. We note that the issue of viability extends to this conclusion as well. If there were major uncertainties concerning project viability, the benefits of deferral to AJS could far outweigh the costs/risk. Given our

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13 The First Amendment also provides AJS with some flexibility to relocate the plant within the same industrial park. In our view, this "benefit" directly offsets the risk to AJS that the parcel of land in the industrial park (for which AJS has been paying purchase options) will not be available in five years. In effect, these two elements of the benefit/cost comparison cancel each other out. (See Figure 1.)

assessment of viability, and the above comparison of benefits/costs to AJS, we conclude that a deferral payment is indeed necessary to gain the ratepayer benefits associated with the First Amendment deferral.

We now examine the relative benefits and costs to ratepayers of the negotiated package, including the deferral payment terms. Guideline III, paragraph 7, states that "on-line date deferrals...may be considered only if the ratepayers' interests will be served demonstrably better by such deferral." There is no controversy over the relevant range of potential ratepayer benefits under this paid deferral. PG&E and DRA agree that ratepayers would realize an estimated \$18 to \$25 million (in NPV), assuming that the project is viable.

As DRA points out, there is always some risk to ratepayers that the project is not viable. While we concur with PG&E that the deferral is most likely to benefit ratepayers (i.e., because it is most likely that the project was viable to begin with), DRA has identified some legitimate uncertainties regarding project viability. As a result, ratepayers are exposed to some risk of nonviability and the associated costs.

Ideally, we would assign specific probabilities to each of the potential outcomes of this agreement, and then derive a weighted average of projected ratepayer net benefits. Were the issue of viability a close call, we would probably need to carefully consider the likelihood of each event. However, as discussed above, we consider the most likely outcomes to be those associated with a viable project. While viability may not be 100% certain, in our judgment it is certainly close. We therefore conclude that the proposed paid deferral complies with Guideline III, paragraph 7. Ratepayers will be served demonstrably better by such deferral, even when the risks of nonviability are taken into account.



PG&E and AJS would argue that these findings are sufficient for approving the reasonableness of the First Amendment terms, including the upfront payment of \$2.9 million. However, we agree with DRA that the deferral agreement should be structured to eliminate as much ratepayer risk as possible. In addition to the risk of nonviability, a paid deferral imposes the added risk of paying to defer a project (even a viable one) that the developer has already decided to abandon.<sup>14</sup> The cost to ratepayers of this risk is the upfront payment of \$2,940,000. Moreover, in making this nonrefundable, upfront payment, ratepayers assume a portion of development risk that is properly allocated to the developer.

DRA proposes to minimize these risks by putting PG&E's shareholders at risk for a portion of the upfront payment. We disagree with that approach. PG&E's ratepayers, and not the shareholders, benefit from reductions in contract overpayments. Moreover, ultimate completion of the project is not a measure of PG&E's aggressiveness in assessing project viability under the unamended contract. Since the allocation of benefits and costs in this deferral agreement are solely between ratepayers and the developer, any proposal to reduce ratepayer risk should affect only these two parties.

Accordingly, we approve the First Amendment subject to the condition that, should the project not be built for any reason, AJS will refund the \$2.9 million upfront payment in full to ratepayers. This condition will satisfy our concerns that AJS

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<sup>14</sup> During the hearings, there was some confusion over the meaning of this term. It does not refer to the ultimate abandonment of a project, due to future events. Rather, it refers to the downside risk that a developer, for a variety of reasons, may have already decided not to pursue the project, even if it could have been built under the original terms of the contract. (See TR at 96.)

fully intends to pursue the project. Moreover, it appropriately places project development risk onto the developer, and not the ratepayer. As we stated in the Guidelines and other orders, we continue to believe strongly that the risk of project development should be borne by the QF developer.<sup>15</sup> In all other respects, the First Amendment terms would remain unchanged.

Thus, our order today is to deny the application, but we will hold the proceeding open, pending receipt of a status report from PG&E. The status report is due no later than 15 days from the effective date of this order. The report will indicate acceptance or rejection of the condition set forth above. In the case of acceptance, the report shall attach revised First Amendment language implementing these terms. If the revisions fully comply with the change described above, we would make a prospective finding that payments by PG&E pursuant to the First Amendment are reasonable and fully recoverable from ratepayers to the same extent as payments pursuant to standard offer power purchase agreements.<sup>16</sup> Pursuant to D.88-10-032 (Conclusion of Law 36), we would confirm that the facility's current Milestone No. 12 deadline under the QFMP is extended to June 27, 1996.

Findings of Fact

1. AJS is the current developer of a 16 MW woodwaste facility located in Soledad, California.
2. Soledad's PPA reflects the terms and conditions of ISO4.

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<sup>15</sup> See, for example, D.88-09-038, p. 4 and D.88-10-032, p. 17.

<sup>16</sup> However, we will reserve the right to examine for reasonableness in the appropriate ECAC proceeding any decision by PG&E to shorten the deferral period under the First Amendment, or to invoke the backup one year nonpaid deferral.

3. Under the terms of the PPA, Soledad is required to be operational by June 27, 1990.

4. Under the terms of the PPA, AJS would be paid fixed energy payments based on 100% of forecasted prices over the fixed price period (10 years). Capacity payments would be fixed and levelized at \$196/kW-year over the 30-year contract.

5. On October 28, 1988, PG&E and AJS signed a letter agreement outlining deferral terms for the Soledad project.

6. On December 29, 1988, PG&E and AJS executed the final deferral agreement, embodied in a First Amendment to the Soledad Power Purchase Agreement.

7. Under the First Amendment, AJS would: (a) defer the project on-line date for five years, except if a shorter deferral period were requested by PG&E; (b) reduce ISO4 energy payments to 90% of fixed, forecasted prices, with 10% based on published prices; (c) reduce ISO4 capacity payments to \$186/kW-year for the first 10 years of the contract; (d) receive \$2,940,000 upfront and \$735,000 (plus interest) when the project begins energy deliveries; and (e) have the option of submitting a new proof of site control, provided the project remains within the Soledad Industrial Park.

8. On March 23, 1989, PG&E filed A.89-03-036 requesting ex parte approval of the First Amendment.

9. On June 7, 1989, DRA filed a limited protest.

10. A day of hearing was held on July 24, 1989 before Commissioner Eckert and ALJ Weissman.

11. The Commission's guidelines on contract administration (Guidelines), adopted in D.88-10-032, require examination of a QF's viability under the unamended contract as a prerequisite to modifications.

12. The Guidelines further state that, in general, deferrals and buyouts should be considered only with QFs who have obtained all of the permits and certification necessary to go forward with their projects.

13. The Guidelines state that on-line date deferrals may be considered only if the ratepayers' interests will be served demonstrably better by such deferral.

14. In D-88-10-032, we reiterated our intention in the QF program to insulate ratepayers from development risk.

15. On August 3, 1988, AJS signed a 10-year contract with a major lumber company for the supply of woodwaste fuel in a region with large stores of waste fuel available.

16. On September 30, 1988, 21 months prior to the five-year deadline, AJS signed a letter of intent with construction contractors outlining terms with strong incentives for timely completion of the project.

17. As of October 28, 1988, when PG&E and AJS signed the deferral letter of intent, AJS had already (a) obtained all necessary permits to go forward with the Soledad project; (b) ordered and placed deposits on major equipment, and (c) solicited and received serious financing proposals from six major banks.

18. By the end of 1988, project lenders had completed their due diligence review of Soledad and were prepared to proceed with documentation and closing of the lending arrangements.

19. Pro forma cash flow projections indicate that the project was financeable under the original contract.

20. Soledad is in full compliance with the QFMP milestones.

21. AJS's parent company, Axel Johnson, Inc. is actively involved in the alternative energy industry.

22. DRA obtained and reviewed the documentation submitted to PG&E by AJS on project viability.

23. DRA concludes that Soledad meets the Commission's threshold test of viability, because there is a reasonable possibility that the project is viable under the original ISO4.

24. AJS's estimated leadtime for projects such as Soledad is 16-18 months.

25. Under the unamended contract, the net return to owner cash flow contains sustained negative returns for the five-year period beginning in year six of the project.

26. If the project is viable under the unamended contract, and ultimately built, the First Amendment saves ratepayers an estimated \$18 to \$25 million (NPV in 1988 dollars) in overpayments.

27. If the project is not viable, and ultimately built, the net costs to ratepayers under the First Amendment is estimated at \$16 to \$29 million.

28. Based on current projections of avoided costs, the five-year deferral period maximizes ratepayer benefits if the project is viable, and minimizes ratepayer costs if the project is nonviable.

29. Ratepayers would be better off under all possible scenarios if they did not need to pay the developer for this deferral.

30. Ratepayers should pay for a deferral only if the costs/risks to the developer appear to substantially outweigh the benefits of deferral.

31. Keeping the project in the company's portfolio for future development would enable AJS management to devote more time to a recently acquired Synergics Company.

32. The deferral may enable AJS to avoid some bonus payments to the construction contractor.

33. Estimates of nonrecoverable development costs, including equipment deposits, permit fees, testing, and reengineering range from \$1.6 (PG&E) to \$2.9 million (AJS).

34. The pricing concessions agreed to in the First Amendment represent payment reductions of \$1.4 to \$2.9 million (in NPV, 1989 dollars).

35. The deferral delays the revenues that AJS would use to offset upfront/bankruptcy disbursements, required as a condition for assumption of the Purchase Power Agreement from the previous developer.

36. Under the First Amendment, AJS assumes all risks that economic or regulatory factors might change to reduce project profitability.

37. In deferring Soledad, AJS will lose certain tax benefits, as reflected in a somewhat lower cash flow and return to owner.

38. There is always some risk to ratepayers that the project is not viable.

39. In addition to the risk of nonviability, a paid deferral with upfront payments imposes the added risk of paying to defer a viable project that the developer has already decided to abandon.

40. Upfront, nonrefundable payments place the ratepayer in the position of assuming QF development risks.

41. DRA's proposal for risk sharing would put PG&E shareholders at risk for a portion of the upfront payment.

42. PG&E's ratepayers, and not shareholders, benefit from reductions in the overpayments associated with standard offers.

43. Completion of Soledad in five years is not a measure of PG&E's aggressiveness in assessing project viability under the unamended contract.

44. The allocation of benefits and costs/risks associated with the First Amendment is between ratepayers and the developer.

#### Conclusions of Law

1. PG&E has met the threshold test of project viability, consistent with our adopted guidelines in D.88-10-032, in negotiating a paid deferral with Soledad.

2. A deferral payment is necessary to gain the ratepayer benefits associated with the First Amendment deferral.

3. Under the most likely scenarios, ratepayers will derive substantial monetary benefits under the terms of the First Amendment, assuming a five-year deferral period.

4. The reasonableness of PG&E to exercise its option under the First Amendment for a shorter deferral should be reviewed in the appropriate ECAC proceeding.

5. Considering the various uncertainties, the proposed upfront payment is unreasonable because it does not adequately mitigate the downside risks to ratepayers, and exposes ratepayers to an unacceptable amount of development risk.

6. In order to mitigate these risks, the upfront payment should be made refundable by the developer if the project is not built.

7. This order should be made effective immediately in order to give PG&E and AJS timely information regarding the status of the proposed First Amendment.

ORDER

IT IS ORDERED that:

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

2. The proceeding shall be held open pending receipt of a status report from PG&E. The report shall be filed and served in this proceeding no later than 15 days from the effective date of this order, and shall indicate whether PG&E and Axel Johnson Soledad, Inc. accept or reject the revised terms described in

Section V of the opinion. In the case of acceptance, the report shall attach revised First Amendment language implementing these terms.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.



Figure 1

Comparison of Costs and Benefits of Soledad  
Deferral to AJS (Without Deferral Payment)

<u>Benefits to Developer</u>	<u>Costs/Risks to Developer</u>
1. Adds flexibility to relocate plant within same industrial park. (TR at 45)	1. Costs estimated at \$1.6 to \$2.9 million (including nonrecoverable deposits and tests) for reengineering (e.g. steam turbine), permitting, and other development activities needed to be/redone. (TR at 31, 49, 53-54)
2. Soledad kept in portfolio as future project while diverting limited management resources to Synergies project. (TR at 55)	2. Payment reductions of \$1.4 to \$2.9 million (in NPV, 1989 dollars) due to pricing concessions during first 10 years. (Exhibit 8)
3. Developer may avoid bonus payments to contractor for construction (and any uncertainty in meeting 5-year deadline). (TR at 132)	3. Risk that economic or regulatory factors might change to reduce profitability (e.g., construction costs, renewal of air quality permit, and associated requirements). (TR at 47, 53)
	4. Risk that the parcel of land in the industrial park (for which AJS has purchase options) is not available in 5 years. (TR at 46-47)
	5. Delay in revenues to cover upfront bankruptcy payment. (TR at 113-114)
	6. Lost tax benefits as reflected in lower NPV of cash flow and return to owner (even with deferral payment). (Exhibit 9)
	7. Change in public relations in Soledad area. (TR at 47)

1 FIRST AMENDMENT  
2 TO THE  
3 POWER PURCHASE AGREEMENT  
4 FOR  
5 LONG-TERM ENERGY AND CAPACITY  
6 BETWEEN  
7 AXEL JOHNSON SOLEDAD, INC.  
8 AND  
9 PACIFIC GAS AND ELECTRIC COMPANY

10 This First Amendment is by and between Pacific Gas  
11 and Electric Company ("PG&E"), a California corporation, and  
12 Axel Johnson Soledad, Inc. ("Seller"), a Delaware  
13 Corporation. PG&E and Seller are sometimes referred to  
14 herein collectively as the "parties" and individually as  
15 "party."

16 RECITALS

17 A. Oeberst & Associates on April 11, 1985, and  
18 PG&E on June 27, 1985, executed an Interim Standard Offer  
19 No. 4 Long-Term Energy and Capacity Power Purchase Agreement  
20 (the "Agreement") for a proposed 16,000 kW biomass facility  
21 to be located at Soledad Industrial Park, Monterey County,  
22 California (the "Facility"). The Agreement was thereafter  
23 assigned by Oeberst & Associates to Seller and acknowledged  
24 by the consent to assignment executed by PG&E on July 5,  
25 1988; and

26 B. Seller has provided documentation and other  
information requested by PG&E regarding the project status  
and the likelihood that Seller would build the Facility and

1 begin energy deliveries within the Agreement's Article 12  
2 five-year deadline. In particular, at PG&E's request,  
3 Seller has submitted information showing, among other  
4 things, that Seller has obtained all of the permits and  
5 certification necessary to go forward with construction and  
6 operation of the Facility and that fuel and construction  
7 financing are available. Seller has proven site control,  
8 has provided a Project Description and Interconnection Study  
9 Request, has paid for a detailed interconnection study, and  
10 is in compliance with the Qualifying Facility Milestone  
11 Procedure. Seller has provided PG&E with a letter from  
12 Seller's turn-key engineering and construction contractor  
13 assuring that Seller would be able to complete the Facility  
14 and begin energy deliveries within the Agreement's Article  
15 12 five-year deadline; and

16 C. Seller has represented that the information  
17 and documentation it has submitted to PG&E to demonstrate  
18 the Facility's viability are true, correct, accurate and  
19 complete. PG&E has relied substantially upon these  
20 representations in determining that the Facility is viable  
21 and that Seller could construct the Facility described in  
22 this Agreement and begin energy deliveries within the  
23 Agreement's Article 12 five-year deadline; and

24 D. Based upon the information and documentation  
25 submitted by Seller, PG&E has determined that the Facility  
26 is viable and that Seller could construct the Facility and

1 begin energy deliveries within the Article 12 five-year  
2 deadline; and

3 E. A key factor in PG&E's assessment of project  
4 viability is the identity of Seller; and

5 F. Despite Seller's confidence that Seller could  
6 construct the Facility and start energy deliveries within  
7 the Agreement's Article 12 five-year deadline, Seller wishes  
8 to defer construction of the Facility because, among other  
9 benefits, Seller could thereby avoid paying a substantial  
10 bonus to its turn-key engineering and construction  
11 contractor, and could make more efficient use of its  
12 economic and physical resources; and

13 G. PG&E wishes to defer the start of energy  
14 deliveries from the Facility in order to avoid in the  
15 interim paying for the Facility's energy at prices higher  
16 than the forecasted alternative replacement energy cost, and  
17 to defer the operation of the Facility until a time when  
18 there is a greater likelihood that PG&E will need the  
19 Facility's capacity. The deferral of the project is  
20 expected to result in substantial ratepayer savings; and

21 H. PG&E and Seller have agreed that energy  
22 deliveries will not begin earlier than March 1, 1995, and  
23 that the Agreement's fixed prices will not be paid for any  
24 deliveries from the Facility which occur prior to June 27,  
25 1995. If deliveries begin on or after March 1, 1995 and  
26 before June 27, 1995, Seller will receive nonfirm, economy

1 energy prices (which may be less than Standard Offer No. 1  
2 published energy prices), but no capacity prices prior to  
3 June 27, 1995; and

4 I. PG&E and Seller have agreed that under  
5 Article 12, initial energy deliveries from the Facility will  
6 occur no later than June 27, 1996; and that this represents  
7 a contractual obligation by Seller for the Facility which  
8 Seller may not breach in order to, among other things, take  
9 advantage of higher prices which may be available in the  
10 future; and

11 J. PG&E and Seller have agreed that during the  
12 fixed price period which shall not begin prior to June 27,  
13 1995, ninety (90) percent of Seller's deliveries shall  
14 receive fixed prices from Table B-1 of the Agreement, and  
15 ten (10) percent shall receive prices based upon PG&E's full  
16 short-term operating costs. The forecasted weighted annual  
17 average energy price in Table B-1 shall be 13.14¢/kWh from  
18 1997 through the end of the fixed price period; and

19 K. PG&E and Seller have agreed that the firm  
20 capacity price in the firm capacity price schedule shall be  
21 fixed at the price applicable for a firm capacity  
22 availability date of 1990, less \$10/kW, for the first 120  
23 months following the Facility's actual firm capacity  
24 availability date. Thereafter Seller shall receive the full  
25 price applicable for a firm capacity availability date of  
26 1990 for a 30-year term of agreement, this results in a firm

1 capacity price of \$186/kw-yr for the first 120 months, and  
2 \$196/kw-year thereafter; and

3 L. PG&E and Seller have agreed that for  
4 as-delivered capacity delivered in excess of firm capacity,  
5 the Seller will be paid under As-delivered Capacity Payment  
6 Option 2, as now specified in the Agreement, except that the  
7 forecast shortage cost in Table D-2 will be fixed at  
8 \$188/kw-yr from 1997, through the end of the term of  
9 agreement; and

10 M. PG&E and Seller have agreed that PG&E will  
11 make a deferral payment of \$3,675,000, which represents a  
12 portion of the reasonable costs incurred by Seller directly  
13 on development of the Facility as of October 24, 1988 for  
14 items that (a) will be lost or no longer used as a direct  
15 result of the deferral, including Investment Tax Credits,  
16 and (b) are not resalable ("Deferral Payment"). Eighty  
17 percent of the total Deferral Payment (\$2,940,000) will be  
18 paid within thirty (30) days after a decision by the CPUC  
19 approving this amended Agreement and unconditionally  
20 authorizing concurrent recovery in rates of all payments  
21 made under the amended Agreement, as provided in Recital O,  
22 becomes final, unconditional and unappealable (including  
23 exhaustion of all administrative or judicial appeals or  
24 remedies, and time periods thereof). The remaining 20  
25 percent (\$735,000), with interest at the three-month  
26 Commercial Paper rate for the previous month published in

1 the Federal Reserve Statistical Release, G.13, will be paid  
2 when energy deliveries begin from the Facility defined in  
3 the Agreement. The interest shall begin to accrue on the  
4 date that the CPUC's decision approving the amended  
5 Agreement, as provided in Recital O, becomes final,  
6 unconditional and unappealable; and

7 N. PG&E and Seller have agreed that PG&E will  
8 accept new proof of site control for the Facility on the  
9 condition that first, the new proof of site control is for a  
10 site entirely within the current boundaries of the "Soledad  
11 Industrial Park, Monterey County, California," which is the  
12 site specified in Article 3(b) of the unamended Agreement;  
13 and second, that Seller provide the new proof of site  
14 control to PG&E within eighteen (18) months prior to the  
15 date of initial energy deliveries from the Facility; and

16 O. PG&E and Seller have agreed to condition this  
17 amendment to the Agreement upon (1) the issuance by  
18 January 1, 1989 of a final, unconditional and unappealable  
19 decision dismissing the lawsuit by Arthur J. Mitteldorf  
20 against the City of Soledad, Industrial Power Technology,  
21 and Axel Johnson Energy Development Company, Inc., Superior  
22 Court of Monterey County, No. 87493, with prejudice, and  
23 (2) a final, unconditional and unappealable decision by the  
24 CPUC approving the reasonableness of the deferral agreement  
25 and unconditionally authorizing recovery in PG&E's rates of  
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1 all payments made under this amended Agreement at the time  
2 the payments are made; and

3 P. PG&E and Seller have agreed that should PG&E  
4 determine that it needs the Facility's energy or capacity  
5 prior to June 27, 1995, PG&E may require that the Facility  
6 become operational prior to June 27, 1995, provided PG&E  
7 gives Seller written notice two years prior to the required  
8 operation date; and

9 THEREFORE, for the mutual promises and obligations  
10 stated herein, Seller and PG&E hereby agree to amend the  
11 Agreement (the "First Amendment") as follows:

12 1. Definitions

13 1.1 All underlined terms shall have the meaning  
14 stated in Section A-1 DEFINITIONS, Appendix A, pages A-2 to  
15 A-7 of the Agreement, except as expressly amended by this  
16 First Amendment.

17 1.2 Amend the definition of "fixed price period"  
18 in Appendix A, page A-4, lines 4 to 12, to read in its  
19 entirety as follows:

20 Fixed price period -- The period during  
21 which forecasted and levelized energy  
22 prices, and/or forecasted as-delivered  
23 capacity prices, are in effect; defined  
24 as the ten-year period beginning on the  
later of either the date of initial en-  
ergy deliveries or June 27, 1995, except  
as otherwise provided in Article 13.

25 1.3 Amend the definition of "firm capacity  
26 availability date" in Appendix A, page A-3, line 21, by



1 adding the following new sentence at the end of the  
2 definition:

3 In no event shall the firm capacity  
4 availability date occur prior to  
5 June 27, 1995, except as otherwise pro-  
vided in Article 13.

6 1.4 Amend the definition of "firm capacity price"  
7 in Appendix A, page A-3, line 26 by deleting the period  
8 (".") and by adding the following phrase:

9 , less \$10/KW for the first 120 months  
10 following the Facility's firm capacity  
availability date.

11 1.5 Add a new definition of "non-firm, economy  
12 energy purchases" in Appendix A, page A-7, line 10 as  
13 follows:

14 Nonfirm, economy energy purchases -- The  
15 lesser of (1) the price paid for energy,  
16 on an as-available basis, from third  
17 party suppliers, and (2) the cost of  
18 incremental energy from PG&E's own gen-  
19 eration/resources. PG&E shall notify  
20 Seller in advance of the nonfirm, econo-  
my energy price. The price identified  
in the notice shall remain in effect  
until PG&E issues a new notice specify-  
ing a new nonfirm, economy energy price.

21 2. New Proof Of Site Control

22 Amend Article 3 PURCHASE OF POWER, page 5, line  
23 12, by adding the following new sentence to the end of  
Article 3(b):

24 PG&E shall accept new proof of site  
25 control for a site entirely within the  
26 boundaries of the Soledad Industrial  
Park which exist as of the effective  
date of the First Amendment, provided

## ATTACHMENT 1

1 that Seller shall submit such new proof  
2 of site control within eighteen (18)  
3 months prior to the date of initial  
4 energy deliveries from the Facility.

5 3. Energy Price

6 3.1 Delete in its entirety the three paragraphs  
7 following the heading "Energy Payment Option 1 - Forecasted  
8 Energy Prices," Article 4 ENERGY PRICE, page 7, line 8  
9 through page 8, line 10, and substitute the following:

10 (i) Seller shall not begin energy  
11 deliveries prior to March 1, 1995, and  
12 PG&E shall have no obligation to accept  
13 or pay for energy deliveries prior to  
14 March 1, 1995. If Seller begins energy  
15 deliveries on or after March 1, 1995 but  
16 prior to June 27, 1995, Seller shall be  
17 paid at prices equal to those PG&E pays  
18 for nonfirm, economy energy purchases.

19 (ii) During the fixed price period,  
20 Seller shall be paid for energy delivered  
21 at prices equal to 90 percent of  
22 the prices set forth in Table B-1, Appendix B,  
23 plus 10 percent of PG&E's full short-run avoided operating costs.

24 (iii) For the remaining years of the  
25 term of agreement following the expiration  
26 of the fixed price period, Seller  
shall be paid for energy delivered at  
prices equal to PG&E's full short-run avoided operating costs.

3.2 Delete Table B-1, Forecasted Energy Price  
Schedule, at Appendix B, page B-2, and substitute "Amended  
Table B-1, Forecasted Energy Price Schedule," which is  
attached as Attachment 1 to this First Amendment and incorporated herein by this reference.

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## ATTACHMENT 1

4. Firm Capacity Price

Delete Table E-2, Firm Capacity Price Schedule, at Appendix E, page E-10, and substitute "Amended Table E-2, Firm Capacity Price Schedule," which is attached as Attachment 2 to this First Amendment and incorporated herein by this reference.

5. As-Delivered Capacity Price

5.1 Amend Appendix D, AS-DELIVERED CAPACITY, by deleting page D-1, line 23, through page D-2, line 15, and by substituting the following:

For the remaining years of the term of agreement, PG&E shall pay Seller for as-delivered capacity at the as-delivered capacity prices that were paid Seller in the last year of fixed price period.

5.2 Delete Table D-2, Forecasted Shortage Cost Schedule, at Appendix D, page D-5, and substitute "Amended Table D-2, Forecasted Shortage Cost Schedule, which is attached as Attachment 3 to this First Amendment and incorporated herein by this reference.

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6. Construction Start Date

Amend the first sentences of Section (f) of Article 3, PURCHASE OF POWER, at page 6, lines 7 to 16, and footnote 1 at line 24, to read:

If Seller does not begin construction of its Facility by (Date) 1/, PG&E may re-allocate the existing capacity on PG&E's transmission and/or distribution system which would have been used to accommodate Seller's power deliveries to other uses.

1/ Seller shall provide this date in the project development schedule to be submitted no later than thirty (30) days after signing the Special Facilities Agreement for the Facility.

7. Deferral Of Start Of Operations

Amend Section (c) of Article 3, PURCHASE OF POWER, page 5, lines 14 to 17, in its entirety to read as follows:

Except as otherwise provided in Article 13, PG&E shall have no obligation to accept or pay for deliveries of capacity from the Facility prior to June 27, 1995, and PG&E shall have no obligation to accept or pay for deliveries of energy from the Facility prior to March 1, 1995.

8. Article 12 Five-Year Deadline

Amend Article 12, TERM OF AGREEMENT, at page 14, lines 6 to 10, in its entirety to read:

This Agreement shall be binding upon execution and remain in effect thereafter for 30 years from the firm capacity availability date; provided, however, that it shall terminate if energy deliv-

eries from the Facility do not start by June 27, 1996.

9. PG&E's Option To Require Facility's Operation Prior To June 27, 1995.

Add the following new Article 13, OPTION TO REQUIRE OPERATION PRIOR TO JUNE 27, 1995, at page 14, line 11:

ARTICLE 13 OPTION TO REQUIRE OPERATION PRIOR TO JUNE 27, 1995

Should PG&E in its sole discretion determine that it needs the Facility's energy or capacity prior to June 27, 1995 for any reason whatsoever, PG&E may at its option require that the Facility begin deliveries of energy and capacity prior to June 27, 1995, on the condition that PG&E give Seller written notice two years prior to the required operation date. If PG&E exercises this option, the required operation date specified in PG&E's written notice to Seller shall be substituted for "June 27, 1995" throughout this First Amendment. The terms and conditions of this First Amendment shall otherwise be unchanged.

10. Deferral Payment

PG&E shall pay Seller \$3,675,000 (the "Deferral Payment"). Eighty percent of the Deferral Payment (\$2,940,000) shall be paid within thirty days after the date that the CPUC decision approving this First Amendment, as required in Paragraph 12 below, becomes final, unconditional and unappealable (including exhaustion of all judicial or administrative appeals or remedies, and time periods thereof) ("Approval Date"). The remaining twenty percent of

1 the Deferral Payment (\$735,000), together with interest  
2 accruing monthly at the three-month Commercial Paper rate  
3 for the previous month as published in the Federal Reserve  
4 Statistical Release, G13, from the Approval Date, shall be  
5 paid within thirty days after the date that energy  
6 deliveries begin from the Facility in accordance with the  
7 Agreement as amended by this First Amendment. Should  
8 publication of the three-month Commercial Paper rate be  
9 discontinued, interest shall accrue at the interest rate of  
10 commercial paper which most closely approximates the  
11 discontinued three-month Commercial Paper rate and which is  
12 published in the Federal Reserve Statistical Release, G13,  
13 or its successor publication.

14 11. Accuracy Of Information And Documentation

15 Seller represents that the information and  
16 documentation which it submitted to PG&E to demonstrate the  
17 Facility's viability are true, correct, accurate and  
18 complete.

19 12. Conditions And Regulatory Review

20 12.1 This First Amendment is conditioned upon and  
21 shall not be effective until (a) the CPUC issues a decision  
22 that in terms satisfactory to PG&E approves the  
23 reasonableness of the First Amendment and the Agreement as  
24 so amended, and unconditionally authorizes full recovery in  
25 PG&E's rates of all payments made under the First Amendment  
26 and Agreement as so amended (including but not limited to

1 the Deferral Payment) at the time the payments are made; and  
2 (b) such CPUC decision becomes final, unconditional and  
3 unappealable (including exhaustion of all administrative and  
4 judicial appeals or remedies and time periods thereof).  
5 PG&E shall inform Seller of the date when this condition has  
6 been satisfied.

7 12.2 This First Amendment is also conditioned upon  
8 and shall not become effective unless (a) by January 1,  
9 1989, a decision is issued dismissing the lawsuit by  
10 Arthur J. Mitteldorf against the City of Soledad, Industrial  
11 Power Technology, Axel Johnson Energy Development Company,  
12 Inc., Superior Court of Monterey County, No. 87493, with  
13 prejudice, and (b) such decision becomes final,  
14 unconditional and unappealable within 180 days thereafter.

15 12.3 PG&E and Seller shall use their best efforts  
16 to support the reasonableness of the First Amendment, and  
17 the Agreement as amended, before any government authority of  
18 competent jurisdiction in a proceeding involving a review of  
19 the First Amendment or the Agreement for purposes of  
20 allowance or disallowance in rates charged by PG&E. Each  
21 party shall bear its own costs and expenses associated with  
22 seeking such approval. Seller shall cooperate with PG&E to  
23 provide to the CPUC all information necessary to demonstrate  
24 the viability of the Facility.  
25 ///  
26 ///

## ATTACHMENT 1

13. Effect On Agreement

Except as expressly modified by this First Amendment, the provisions of the Agreement shall remain unchanged.

14. Entire Agreement

The First Amendment constitutes the entire agreement of the parties with respect to the subject-matter thereof and supersedes any and all prior negotiations, correspondence, understandings and agreements between the parties respecting the subject-matter of this First Amendment.

15. Modification

This First Amendment may be further amended or modified only by a written instrument signed by the parties hereto.

16. Captions

Captions are included herein for ease of reference only. The captions are not intended to effect the meaning of the contents or scope of this First Amendment.

17. Choice Of Laws

This First Amendment shall be construed and interpreted in accordance with the laws of the State of California, excluding any choice of law rules that may direct the application of the laws of another jurisdiction.

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18. Non-Waiver

Failure by either party hereto to enforce any right or obligation with respect to any matter arising in connection with this First Amendment shall not constitute a waiver as to that matter or any other matter.

19. Notices

Amend Article 9, NOTICES, at page 13, lines 8-9 to replace "Vice President - Electric Operations" with "Vice President - Power Generation."

20. Interpretation

This First Amendment is the result of negotiation. Moreover, each party has reviewed this Amendment, and has had full and adequate opportunity to obtain legal advice regarding this Amendment from the legal counsel of its choice. Accordingly, the rule of construction in Civil Code § 1654 to the effect that any ambiguity shall be resolved against the drafting party shall not be employed against either party in the interpretation of this Amendment.

21. Confidentiality

Seller and PG&E agree to keep, and agree that they shall cause their respective counsel, consultants and agents to keep, this First Amendment confidential except for purposes of financing, disclosures to the CPUC or its staff (including the Division of Ratepayer Advocates and its counsel) for purposes of fulfilling the parties' obligations under Paragraph 12 (Conditions and Regulatory Review) of

1 this First Amendment, to the California Energy Commission,  
2 or where either party is required by law to disclose it.

3 22. Counterparts

4 This First Amendment may be executed in two or  
5 more counterparts, each of which shall be deemed an original  
6 and all of which shall constitute one and the same  
7 instrument.

8 IN WITNESS WHEREOF, the parties hereto have caused  
9 this First Amendment to be executed by their duly authorized  
10 representatives, and it is effective as of the last date set  
11 forth below:

12 AXEL JOHNSON SOLEDAD, INC.

PACIFIC GAS AND ELECTRIC COMPANY

14 BY: Michael L. Leighton

BY: Robert J. Haywood

15 NAME: Michael L. Leighton

NAME: ROBERT J. HAYWOOD

16 TITLE: President

TITLE: Vice President

17 DATE

DATE

18 SIGNED: December 29, 1988

SIGNED: December 29, 1988. *WA*

19 NOTICE

20 ADDRESSES: 110 East 59th St.  
New York, NY 10022  
21 Attn: Michael L.  
Leighton

Pacific Gas and Electric  
Company  
Attn: Manager, QF Contracts  
77 Beale Street, 23rd Floor  
San Francisco, CA 94106

AMENDED TABLE B-1  
FORECASTED ENERGY PRICE SCHEDULE

Year of Energy Deliveries	Forecasted Energy Prices*, c/kwh						Weighted Annual Average
	Period A			Period B			
	On-Peak	Partial-Peak	Off-Peak	On-Peak	Partial-Peak	Off-Peak	
1983	5.36	5.12	4.94	5.44	5.31	5.19	5.18
1984	5.66	5.40	5.22	5.74	5.61	5.48	5.47
1985	5.75	5.48	5.30	5.83	5.69	5.56	5.55
1986	5.99	5.72	5.52	6.08	5.94	5.80	5.79
1987	6.38	6.08	5.88	6.47	6.32	6.17	6.16
1988	6.94	6.62	6.39	7.03	6.87	6.71	6.70
1989	7.60	7.25	7.00	7.70	7.53	7.35	7.34
1990	8.12	7.74	7.48	8.23	8.04	7.85	7.84
1991	8.64	8.24	7.96	8.75	8.56	8.35	8.34
1992	9.33	8.90	8.60	9.46	9.24	9.02	9.01
1993	10.10	9.63	9.30	10.23	10.00	9.76	9.75
1994	10.91	10.41	10.06	11.06	10.81	10.55	10.54
1995	10.61	10.13	9.78	10.76	10.51	10.26	10.25
1996	10.40	10.88	10.51	11.57	11.30	11.03	11.02
1997	13.61	12.98	12.54	13.79	13.48	13.15	13.14
1998	13.61	12.98	12.54	13.79	13.48	13.15	13.14
1999	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2000	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2001	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2002	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2003	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2004	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2005	13.61	12.98	12.54	13.79	13.48	13.15	13.14
2006	13.61	12.98	12.54	13.79	13.48	13.15	13.14

\* These prices are differentiated by the time periods as defined in Table B-4 and subsequently amended by the CPUC.

AMENDED TABLE E-2  
FIRM CAPACITY PRICE SCHEDULE

FIRM CAPACITY AVAILABILITY DATE	Number of Years of Firm Capacity Delivery																	
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	20	25	30
1988	102	106	109	113	116	119	122	125	128	131	134	137	140	142	145	156	165	172
1989	110	114	117	121	124	128	131	134	137	141	144	147	149	152	155	167	176	184
1990	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1991	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1992	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1993	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1994	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1995	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196
1996	118	122	126	129	133	137	140	144	147	150	154	157	160	163	165	178	188	196

ATTACHMENT 3

AMENDED TABLE D-2

FORECASTED SHORTAGE COST SCHEDULE

<u>Year</u>	<u>Forecast Shortage Cost, \$/KW-Year</u>
1995	164
1996	176
1997	188
1998	188
1999	188
2000	188
2001	188
2002	188
2003	188
2004	188
2005	188
2006	188

attested to by PG&E. Upon approval of its reapplication for a critical path permit, AJS would receive an additional \$294,000, with interest at the three-month Commercial paper rate. The remaining \$1,176,000 (also with interest), would be paid when energy deliveries begin from the facility, as defined in the agreement. These payments would all be recoverable in PG&E's ECAC rates. In all other respects, the First Amendment terms would remain unchanged.

The ALJ's proposed decision would make the upfront payment fully refundable if the project was not ultimately brought on-line. In its comments, AJS argued that this approach is contrary to recently enacted Public Utilities Code § 2826, which requires cash upfront payments to be fully refundable for projects that do not have all of their permits. AJS argues that the new law exempts from this requirements projects, such as Soledad, for which all necessary permits have been received. We disagree. Although the law now requires refundability when some permits have not been received, it does not preclude us from extending similar requirements to other paid deferral arrangements. Nonetheless, we choose not to require such a refund arrangement here, because of the convincing showing as to project viability.

Thus, our order today is to deny the application, but we will hold the proceeding open, pending receipt of a status report from PG&E. The status report is due no later than 15 days from the effective date of this order. The report will indicate acceptance or rejection of the revised terms set forth above. In the case of acceptance, the report shall attach revised First Amendment language implementing these terms. If the revisions fully comply with the terms outlined above, we would make a prospective finding that payments by PG&E pursuant to the First Amendment are reasonable and fully recoverable from ratepayers to the same extent as payments pursuant to standard offer power purchase.

agreements.<sup>16</sup> Pursuant to D.88-10-032 (Conclusion of Law 36), we would confirm that the facility's current Milestone No. 12 deadline under the QFMP is extended to June 27, 1996.

Findings of Fact

1. AJS is the current developer of a 16 MW woodwaste facility located in Soledad, California.
2. Soledad's PPA reflects the terms and conditions of ISO4.
3. Under the terms of the PPA, Soledad is required to be operational by June 27, 1990.
4. Under the terms of the PPA, AJS would be paid fixed energy payments based on 100% of forecasted prices over the fixed price period (10 years). Capacity payments would be fixed and levelized at \$196/kW-year over the 30-year contract.
5. On October 28, 1988, PG&E and AJS signed a letter agreement outlining deferral terms for the Soledad project.
6. On December 29, 1988, PG&E and AJS executed the final deferral agreement; embodied in a First Amendment to the Soledad Power Purchase Agreement.
7. Under the First Amendment, AJS would: (a) defer the project on-line date for five years, except if a shorter deferral period were requested by PG&E; (b) reduce ISO4 energy payments to 90% of fixed, forecasted prices, with 10% based on published prices; (c) reduce ISO4 capacity payments to \$186/kw-year for the first 10 years of the contract; (d) receive \$2,940,000 upfront and \$735,000 (plus interest) when the project begins energy deliveries; and (e) have the option of submitting a new proof of site control, provided the project remains within the Soledad Industrial Park.

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<sup>16</sup> However, we will reserve the right to examine for reasonableness in the appropriate ECAC proceeding any decision by PG&E to shorten the deferral period under the First Amendment, or to invoke the backup one year nonpaid deferral.

44. PG&E's ratepayers, and not shareholders, benefit from reductions in the overpayments associated with standard offers.

45. Completion of Soledad in five years is not a measure of PG&E's aggressiveness in assessing project viability under the unamended contract.

46. The allocation of benefits and costs/risks associated with the First Amendment is between ratepayers and the developer.

Conclusions of Law

1. PG&E has met the threshold test of project viability, consistent with our adopted guidelines in D.88-10-032, in negotiating a paid deferral with Soledad.

2. A deferral payment is necessary to gain the ratepayer benefits associated with the First Amendment deferral.

3. Under the most likely scenarios, ratepayers will derive substantial monetary benefits under the terms of the First Amendment, assuming a five-year deferral period.

4. The reasonableness of PG&E to exercise its option under the First Amendment for a shorter deferral should be reviewed in the appropriate ECAC proceeding.

5. Considering the various uncertainties, the proposed upfront payment is unreasonable because it does not adequately mitigate the downside risks to ratepayers, and exposes ratepayers to an unacceptable amount of development risk.

6. This order should be made effective immediately in order to give PG&E and AJS timely information regarding the status of the proposed First Amendment.

ORDER

IT IS ORDERED that:

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

2. The proceeding shall be held open pending receipt of a status report from PG&E. The report shall be filed and served in this proceeding no later than 15 days from the effective date of this order, and shall indicate whether PG&E and Axel Johnson



Soledad, Inc. accept or reject the revised terms described in Section V of the opinion. In the case of acceptance, the report shall attach revised First Amendment language implementing these terms.

This order is effective today.

Dated NOV 22 1989, at San Francisco, California.

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