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SEP 9 1991

Decision 91-09-029 September 6, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| Application of Pacific Gas and Electric Company for Authority, Among Other Things, to Increase Its Rates and Charges for Electric and Gas Service. (Electric and Gas) U29M | ORIGINAL Application 82-12-48 (Petition for Modification filed July 26, 1990) |

## OPINION

### 1. Summary

On July 26, 1990, PSE, Inc., along with Granite Road CoGen, Inc., Badger Creek CoGen, Inc., Live Oak CoGen, Inc., and McKittrick CoGen, Inc., each a wholly owned subsidiary of PSE, Inc.[1] (collectively herein "PSE") filed a petition to modify Decision (D.) 87-09-025.[2] PSE requests an extension of the Standard Offer 2 (SO2) capacity price table from 1991 to include one additional year (1992) and an escalation of the 1991 capacity price from $202 per kilowatt-year (/kW-year) to $213/kW-year for 1992. By today's decision, we deny PSE's petition for capacity price escalation and affirm that PSE has five years from final contract execution to bring four projects on-line at a levelized capacity price for the life of the contract of $202/kW-year.

1 PSE, Inc. is now known as Destec Holdings, Inc., having formally changed its name on December 14, 1990. To avoid confusion, petitioner continued to refer to itself as PSE, Inc., and we do so as well.

2 In D.87-09-025 the Commission granted Pacific Gas and Electric Company's (PG&E) Petition for Modification of D.83-12-068. In D.83-12-068 the Commission had adopted capacity price tables for various standard offers, including SO2, through 1988, and in its Petition PG&E requested that the Commission extend and escalate capacity price tables for SO2 Qualifying Facilities (QFs) for 1989-1991.

## 2. Issue

PSE and PG&E fully executed four SO2 contracts on May 29, 1987. No party disputes that under the terms of SO2, PSE has five years from final contract execution to bring these projects on-line. The price paid for the capacity supplied by a project depends on the year that the project begins operation and the length of the contract. By D.87-09-025 we extended previous capacity price tables and escalated SO2 capacity prices through 1991. The issue here is what the capacity price should be if PSE's projects come on-line in 1992. PSE argues that the price should be escalated to a level of $213/kW-year for a 20-year contract. PG&E and the Commission's Division of Ratepayer Advocates (DRA) argue that the existing approved capacity price should be continued to 1992 at the 1991 level of $202/kW-year without escalation.

## 3. Background

The Commission granted an emergency motion on March 19, 1986 to suspend SO2 (D.86-03-069) and, after hearing, indefinitely suspended SO2 on May 7, 1986 (D.86-05-024).[3] We gave direction in D.86-05-024 for the completion of contracts that were pending on the date of suspension. PG&E and PSE were unable to resolve disputes regarding several pending PSE SO2 power purchase agreements (PPAs). On May 28, 1986, PSE filed a complaint requesting that the Commission order PG&E to execute SO2 contracts with PSE. The Commission ordered PG&E to sign SO2 contracts for five projects, and to sign a contract for a sixth project upon PSE providing PG&E a notarized copy of a site control letter within 10

3 SO2 is one of four standard offers we require electric utilities to make available for the purchase of electricity from cogenerators and small power producers.

days of the Commission decision (D.86-12-061, effective December 17, 1986).[4]

**3.1 PSE Petition to Modify**

In its Petition PSE argues that because it was required to institute litigation against PG&E to enforce contract performance (via D.86-12-061), PSE's contracts were not signed until 1987. (According to PG&E, PSE executed the PPAs on April 30, 1987 and PG&E did so on May 29, 1987.) PSE has five years under SO2 to bring its projects on-line (until May 1992). Since PSE's projects may not be operational until 1992, beyond the time covered under the existing SO2 capacity price tables, PSE seeks an extension and escalation of the capacity prices to promote completion of project financing.

PSE proposes a simple mathematical calculation of the 1992 price using the assumptions understood to have been used in the previous extension and escalation (D.87-09-025). According to PSE, this increases the 1991 levelized capacity value from $202/kW-year to $216/kW-year for 1992 (a 7% increase with an energy reliability index (ERI) of 1.0 for 1989-1992). (PSE subsequently filed a revised request for relief that lowered the escalation from 7% to 5.65%.) PSE argues that:

> "...the Commission stated [in D.87-09-025] that a QF [Qualifying Facility] 'must have such a schedule established for all years in which the QF could come on-line' (id.) and concluded, as a matter of law, that QFs 'are entitled to receive levelized capacity prices derived by

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4 Granite Road CoGen, Inc., Badger Creek CoGen, Inc., Live Oak CoGen, Inc., and McKittrick CoGen, Inc. are four of the six projects addressed in D.86-12-061. The other two projects are Bear Mountain and Chalk Cliff. The Bear Mountain project and another project known as Kern Bluff are the subject of Application (A.) 90-05-037, which seeks approval of an amendment to the power purchase agreement with Bear Mountain, including the termination of the Kern Bluff project.

> extending and escalating Table VI-4***.' id., Conclusion of Law No. 1, p. 16." (PSE Petition, p. 2.)

Finally, PSE argues that:

> "No hearing is required because here, as the Commission there [D.87-09-025] concluded, 'filling in the additional years is a ministerial act.' id. at p. 7." (PSE Petition, pp. 2-3.)

3.2 PG&E Protest

In its formal protest, PG&E contends that PSE's petition should be denied for two reasons. First, what PSE is really requesting, according to PG&E, are 1987 SO2 PPAs, despite the Commission's suspending SO2's in 1986. When the Commission allowed PSE to cure defects in its 1986 submittal, it entitled PSE to 1986 SO2 PPAs only, PG&E asserts. In support, PG&E cites D.88-08-054 ("Crockett"), wherein the Commission rejected the proposition that a QF is entitled to escalated capacity prices when a project's operating date is delayed due to force majeure.

Second, the requested relief is based on PSE's own failure to comply fully with SO2 signature prerequisites in 1986, according to PG&E. PG&E argues that PSE should not be permitted a multi-million dollar windfall (estimated by PG&E to be $15 million in 1990 dollars) because of PSE's own errors.

3.3. Division of Ratepayer Advocates (DRA) Protest

DRA filed a timely protest. DRA argues that by D.87-09-025 the Commission has already extended and escalated the capacity price table for projects which begin operation as late as 1991 (or five years after the 1986 suspension of SO2). The Commission recognized the reasonable expectations of QFs at the time of the SO2 suspension, according to DRA. Since the escalation of the firm capacity price table to 1991 made QFs whole based on their reasonable expectations at the time they accepted SO2, DRA argues that PSE actually is seeking to be made better off.

DRA asserts that the mere fact PSE has until 1992 to bring its projects on-line does not entitle PSE to escalated capacity prices. DRA claims that according to D.89-04-081 ("Colmac"), the time spent on litigation may entitle a QF to an extension of its on-line date but does not entitle the QF to an escalation of a firm capacity price.

3.4 PSE's Reply

On December 14, 1990, PSE filed a reply to the protests of PG&E and DRA. PSE asserts the delays in PSE's projects were caused by PG&E's improper refusal to sign those contracts, as PSE claims the Commission found in D.86-12-061. PSE charges it is PG&E--not PSE--who seeks to benefit from its own failure to comply with the Commission's orders.

Moreover, PSE asserts it seeks only to be made whole by the extension and escalation, and that ratepayers will benefit. PSE claims that an extension and escalation of the capacity price table would provide PSE only with the economic equivalent of the 1986 PPA to which the Commission already has determined it is entitled. Since PSE did not obtain its fully executed contracts until 1987 and thus has until 1992 to bring the projects on-line, the correct measure of the full avoided cost would reflect the increase in costs that result from inflation, according to PSE.

PSE claims that PG&E and DRA err when they claim that PSE is attempting to make itself better off. PSE asserts their comparisons incorrectly ignore the cost side of the equation and assume that PSE is required to deliver power to PG&E in 1992 at 1991 prices.

PSE argues the proper comparison uses 1991 capacity prices for a 1991 on-line date and 1992 capacity prices for a 1992 on-line date. PSE estimates that customers benefit from the deferral of PSE's projects by $8.8 million (net present value to 1990). In addition, PSE claims that extending the capacity price table is consistent with Commission policy. PSE argues D.88-08-054

and D.89-04-081 are distinguishable from its own circumstances. Moreover, PSE claims that D.88-08-054 (at mimeo. p. 9) establishes the principle that QFs are entitled to capacity prices fixed under the planning assumptions current when their contract is signed with the utility.

Finally, PSE claims equitable and public policy considerations favor extension and escalation of the capacity price table. PSE asserts it had no control over PG&E's execution of its contracts, and that any delays are attributable to PG&E. California public policy is designed to encourage the development of cogeneration (Public Utilities Code §§ 821, et seq.), claims PSE. PSE asserts that it is not asking to be treated differently than other QFs, and that its situation is comparable to the extensions granted other QFs which signed contracts in 1986 and have had five years from contract signing to come on-line.

### 3.5 PSE Motion for Leave to File Supplemental Pleading and Revised Request for Relief

On February 26, 1991, PSE filed its "Motion of PSE Inc. for Leave to File Supplemental Pleading and Revised Request for Relief." PSE seeks receipt of the additional material to provide a more complete record, narrow the issues, and propose a significant concession in the requested relief that, according to PSE, warrants the Commission's consideration.

PSE presents several arguments in its supplemental pleading. First, PSE argues that the issue is whether PSE's absolute right to a five-year period to bring the projects on-line can be effectively diminished by restricting the capacity payments PSE will receive should the projects not come on-line until 1992. Citing D.89-04-081 and D.88-08-054 PSE states that:

> "It is true the Commission has declined to both extend and escalate capacity prices in circumstances where litigation or 'force majeure' events have precluded the QF from commencing project operations within five years

of contract execution." (PSE Supplemental Pleading, p. 3; emphasis in original.)

PSE argues this case, however, does not involve interruption of the five-year project development by either litigation or "force majeure" events. PSE asserts that it is not asking the Commission to extend its five-year deadline and to escalate capacity prices due to external events occurring before contract execution which may have precluded its ability to commence operations within the original five-year period. Rather, PSE is asking only that it be allowed to exercise its right to come on-line within the prescribed five-year period. PSE asserts this is a different situation than those the Commission has previously addressed.

Second, PSE claims that its request is consistent with stated Commission policy. PSE notes the Commission explained why the five-year period begins when the contract has been executed by both parties as follows:

> "The five-year requirement should begin on the earliest date a QF can be reasonably expected to pursue project development. A QF cannot be expected to approach financing institutions, fuel suppliers, or government entities without a fully executed contract. PG&E's Interim Standard Offer No. 4 language clearly states that the agreement is effective as of the last signature date. To expect a QF to commence development activities prior to the effective date of the agreement would be unreasonable. (See D.88-10-03 [sic; should be D.88-10-032], mimeo. at p. 28; emphasis added)." (PSE Supplemental Pleading, p. 4.)

Third, PSE argues the ultimate resolution of its petition should be based on considerations of fairness and equity inherent in D.87-09-025. In that regard, PSE notes the earliest the contracts could have been signed was January 1987, after the issuance of D.86-12-061. Contracts were finally executed in mid-1987. PSE relied on its entitlement to the same five-year period

enjoyed by other QFs, never waived or otherwise forfeited this important right, and planned on this basis. Citing D.86-10-038, PSE argues that the Commission has rejected arguments that escalating capacity tables would have a detrimental impact upon PG&E's ratepayers where, as here, entitlement to escalated prices has been demonstrated.

Finally, PSE asserts it has diligently pursued development, construction, and ultimate operation of the instant projects. It has not been in PSE's interest to intentionally delay the start-up of such projects to 1992, according to PSE. PSE argues that it alone among QFs should not be denied its right to a full five years in which to come on-line at capacity prices which reflect the fact that costs invariably increase over time.

Notwithstanding these arguments, PSE reduces its request for relief. PSE says it is not unmindful of the Commission's ongoing concern about the impact of utility-QF power purchases upon California ratepayers. PSE argues that its reply to the protests of PG&E and DRA demonstrates that PSE's commencement of operations in 1992 would actually benefit ratepayers. Nevertheless, PSE modifies its petition to base the requested escalation on the escalation rate for capital construction costs forecast by PG&E itself in its most recent general rate case proceeding. This escalation is 5.65% from 1991 to 1992, according to PSE.

### 3.6 Opposition of PG&E to Motion of PSE Inc. for Leave to File Supplemental Pleading and Revised Request for Relief

On March 28, 1991, PG&E filed an opposition to PSE's Motion for Leave to File Supplemental Pleading and Revised Request for Relief. PG&E argues that the motion should be denied since PSE does not explain why the points made in the supplemental pleading were not included in the reply PSE filed on December 14, 1990.

Should the Commission grant the motion, PG&E offers several comments. First, PG&E claims that PSE incorrectly persists in asserting that denial of the petition will have the effect of depriving PSE of the full five-year development period called for in its SO2 PPAs. PG&E does not dispute that PSE has a full five years to bring the projects on-line.

Second, PG&E argues that the only issue is whether PSE is entitled to additional profits under its SO2s due to the fact that the relevant SO2s were not signed until 1987. PG&E argues:

> "The Commission's December 17, 1986 decision (D.86-12-061) makes clear that what was being granted PSE was the ability to execute SO2s as if it had done so before the 1986 suspension of the availability of SO2." (Opposition of PG&E, p. 6; emphasis in original.)

Finally, according to PG&E, PSE gratuitously offers to decrease the inflation figure used in calculating the escalation rate. This decrease from 7% to 5.65% reduces the windfall to PSE, asserts PG&E, from $15.0 million to $12.3 million net present value (using 1990 dollars). PG&E argues, however, that the result urged by PSE is still inappropriate.

4. Prehearing Conference

A prehearing conference was held on June 5, 1991. No party requested the opportunity to submit testimony or briefs. PSE, in fact, asserts that it will take 8 to 12 months after a Commission decision for the projects to come on-line and that hearings will delay the issuance of a decision. PSE indicates that it is satisfied with the Commission making a decision based on the material that has been filed, and that any delay may jeopardize the projects.

The administrative law judge (ALJ) granted PSE's motion for leave to file its supplemental pleading and revised request for relief. Since PG&E and DRA argued that hearings might be necessary if the supplemental pleading was allowed, the ALJ allowed them

seven days (until June 12, 1991) to file motions, including offers of proof, requesting hearings. No motions were filed.

5. Discussion

In indefinitely suspending SO2, we stated regarding projects impacted by the suspension:

> "In essence, the matter to be resolved as to a given project is the project's status on the date of the Standard Offer 2 suspension (March 19, 1986). If the project had reached a stage by that date where it could have satisfied all contract signing prerequisites... then that developer should have a reasonable opportunity to cure deficiencies in its submittals as they existed when the suspension occurred." (D.86-05-024, Conclusion of Law 2, 21 CPUC 2d 137.)

We expected the curing of deficiencies to be prompt, since a "reasonable opportunity" is neither an indefinite nor excessive period. Contract execution should be equally prompt. Upon quickly completing this process, we expected the QF to be entitled to that which the QF was entitled immediately before the SO2 suspension on March 19, 1986, neither more nor less.

Because SO2 did not contain contract capacity prices for five years after 1986, by D.87-09-025 we added prices for years 1989 through 1991, saying:

> "...the QF has five years after signing its contract within which to come on-line. Consequently, a QF that is entitled to a capacity price schedule determined as of the date of contract execution must have such a schedule established for all years in which that QF could come on-line." (D.87-09-025, mimeo. p. 5.)

By adding prices through 1991, we added the prices to which a QF could expect to be entitled upon promptly curing a contract deficiency and rendering the contract valid as if signed immediately before the SO2 suspension (March 19, 1986).

PSE and PG&E failed to reach agreement on several contracts. PSE filed a complaint. By D.86-12-061 (effective December 17, 1986) we ordered PG&E to sign SO2 contracts for five projects and to sign an SO2 contract for a sixth project contingent upon PSE providing PG&E a notarized copy of a site control letter within 10 business days of the effective date of the decision. We were not aware of any reason for the parties to wait even 10 business days to sign the contracts for the five projects. For the sixth project, we gave PSE days (not months) to cure the one deficiency, just as we provided days (not months) in D.86-03-069 (Crossflow Hydroelectric given seven days) and D.86-05-024 (Jaoudi Industrial & Trading Corporation given 10 days). Upon receipt of the notarized copy of a site control letter, we were not aware of any reason for the parties to further delay contract signing.

We referred to the six projects as "1986 projects" (e.g., see Finding of Fact 3, Conclusion of Law 2, Ordering Paragraph 1 in D.86-12-061). Upon curing the one deficiency for one project and signing the six contracts, our intent was for the "1986" projects to have five years from contract signing to come on-line, but at the prices a QF could reasonably expect at the time of the SO2 suspension. The prices that could reasonably be expected at the time of the SO2 suspension are the prices for a contract as if fully executed immediately before the date of suspension (March 19, 1986). As we said in D.86-12-061:

> "By D.86-03-069 and D.86-05-024, the Commission intended to end the availability of Standard Offer 2 as of March 19, 1986." (23 CPUC 2d 63.)

PSE and PG&E were unable to complete the six contracts until May 1987. PSE argues that the five-year period--to 1992--in which it may bring the projects on-line can be effectively diminished by restricting the capacity payments PSE will receive from PG&E. PSE asserts it is eligible to receive the economic

equivalent of the 1986 PPA, which is the 1991 capacity price escalated to 1992. We disagree.

Our intent was to allow a "reasonable opportunity" for QFs to cure deficiencies and thereby become eligible for a capacity price no greater than that which the QF would be eligible to receive five years after the suspension, or 1991. We have stated this principle in similar cases. For example, in D.88-08-054 we said:

> "Even if Crockett were to win its force majeure claim and so extend its permissible on-line date, we reject the proposition that it also would be entitled to escalated capacity prices." (D.88-08-054, mimeo. p. 9.)

While the circumstances were somewhat different for Crockett than PSE, the principle is the same: to allow the QF the full five years from contract execution to come on-line, but without an escalated capacity price. We extend, but do not escalate, the capacity price.

While the exact circumstances for Colmac were somewhat different than PSE, we applied the same principle in D.89-04-081. There we granted Colmac an extension of 184 days for project completion (unless the parties agreed to another number of days), but we said:

> "The tables setting out the payments for firm capacity and for energy for the first ten years of operation should be extended, but not escalated, to accommodate a new firm operation date to be agreed on by the parties." (D.89-04-081, Conclusion of Law 8, 31 CPUC 2d 572.)

We found that Colmac had:

> "...wound down and eventually suspended its construction activities after receiving Edison's letter of November 3, 1987 [wherein Edison disapproves a site relocation to which it had earlier agreed]." (Id., 571).

Colmac filed a complaint with the Commission on November 12, 1987. Our decision was issued April 26, 1989. Having "wound down and eventually suspended construction activities" pending the resolution of its complaint at the Commission, Colmac expected not only an extension but also an escalation. Arguably, a vindicated complainant might deserve capacity price escalation when it was required to suspend activities pending our decision. We concluded, however, that no escalation was appropriate.

In contrast:

> "Since execution of the subject Standard Offer # 2 contracts in 1987, PSE has diligently pursued development, construction and ultimate operation of the related facilities." (PSE Supplemental Pleading, p. 7.)

If it was not equitable to escalate Colmac's capacity price table, given these facts, it is certainly not equitable to do so for PSE.

PSE argues that it is entitled to escalated capacity prices even if escalated prices would have a detrimental effect on ratepayers, citing D.86-10-038. In D.86-10-038, however, we authorized capacity prices for Standard Offer 4 (SO4) only through 1990. This provides capacity prices up to five years after the suspension of SO4. (See D.85-04-075 and D.85-07-021 for the suspension of SO4.) We did not establish escalated capacity prices beyond 1990 for SO4. Therefore extension (but not escalation) of SO2 capacity prices for five years after SO2 suspension is consistent with our administration of SO4 capacity prices following SO4 suspension. The result here is the same for SO2 as that for SO4.

PSE avers it has diligently pursued ultimate operation of the instant projects. Since D.87-09-025, PSE has been certain of receiving $202/kW-year. PSE's only concern is that financing has been made difficult since financiers may be confused by the price to which PSE is entitled as a result of D.87-09-025. To the extent that is a problem, we solve that dilemma with this decision.

We also consider whether PG&E might have intentionally delayed contract signing to harm these projects. That is, after we directed PG&E to sign SO2 contracts for five projects and sign the contract for a sixth project if a notarized site control letter was provided within 10 business days, PG&E might have continued to delay. Improper delay by PG&E might harm the projects, particularly if there would be no capacity price escalation. We would not want that to occur, and, if such action were proven, we might resolve the issue before us differently. But PSE here neither asserts:

> "...nor does PSE contend that affirmative action on its petition is required as a result of any conduct on PG&E's part in executing and administering the contracts which are the subject of this proceeding." (Motion Of PSE For Leave To File Supplemental Pleading And Revised Request for Relief, p. 2.)

Therefore, there is no basis to find any PG&E conduct improper.

6. Conclusion

We find no basis to deviate from our basic principle that the QF has five years from final contract execution to come on-line at capacity prices extended to the year of operation but not escalated past 1991. In this case, PSE has five years after final execution of the four SO2 contracts subject to this petition to bring the four projects on-line at a levelized capacity price of $202/kW-year.

Findings of Fact

1. SO2 was suspended as of March 19, 1986 by D.86-03-069 and indefinitely suspended as of March 19, 1986 by D.86-05-024.

2. In D.86-05-024 we stated that a QF which could have, but had not, satisfied all contract signing prerequisites as of March 19, 1986 should have a reasonable opportunity to cure deficiencies in its submittals as they existed on March 19, 1986.

3. A reasonable opportunity is neither an indefinite nor an excessive period.

4. SO2 contracts are to be executed promptly upon the QF curing deficiencies that existed as of March 19, 1986.

5. Upon curing deficiencies that existed as of March 19, 1986 and executing an SO2 contract, the QF is entitled to that which the QF could reasonably expect for a contract as if fully executed immediately before the SO2 suspension on March 19, 1986.

6. By D.87-09-025 we added capacity prices for SO2 through 1991, or the full five years a QF could reasonably expect for an SO2 contract executed immediately before the SO2 suspension on March 19, 1986.

7. Where appropriate we apply the principle that a QF has five years from final standard offer contract execution to come on-line at the prices the QF could expect for contracts fully executed immediately before the standard offer suspension (i.e., an extension but no escalation of the capacity price).

8. We discussed or applied this principle in D.88-08-054 (Crockett) and D.89-04-081 (Colmac).

9. Colmac wound down and eventually suspended construction pending a Commission decision.

10. We found that despite the fact that Colmac suspended construction pending our decision, it was entitled to an extension but not an escalation of the capacity price.

11. It was not equitable to escalate Colmac's capacity price despite construction termination, and it is not equitable to escalate PSE's capacity price.

12. Extension but not escalation of SO2 capacity prices for five years after SO2 suspension is consistent with our administration of SO4 capacity prices after SO4 suspension.

13. No party asserts that PG&E's execution and administration of the contracts which are the subject of this proceeding have been improper.

Conclusions of Law

1. The firm capacity price to which PSE is entitled should be extended from 1991 to 1992, but not escalated.

2. The order should be effective on the date signed to satisfy PSE's need for timely disposition of its petition.

## O R D E R

**IT IS ORDERED** that PSE, Inc., Granite Road CoGen, Inc., Badger Creek CoGen, Inc., Live Oak CoGen, Inc., and McKittrick CoGen, Inc. (collectively herein "PSE") have five years from final contract execution to bring their projects on-line at a levelized capacity price for the life of the contract of $202 per kilowatt per year. Except to the extent thus granted, PSE's petition to modify Decision 87-09-025 is denied. This proceeding is closed.

This order is effective today.

Dated September 6, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

I abstain.

/s/ G. MITCHELL WILK
Commissioner

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

NEAL J. SHULMAN, Executive Director