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Decision 91-09-071 September 25, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas and Electric Company (U 902-E) for an Ex Parte Order Approving Settlement and Power Purchase Agreement with Oceanside Refrigeration, Inc.	Application 91-05-063 (Filed May 31, 1991)

ORIGINAL

OPINION

Summary

The Commission grants San Diego Gas & Electric Company's (SDG&E) request for an ex parte order approving and finding reasonable a settlement entered into between SDG&E and Oceanside Refrigeration, Inc. (ORI) resolving a dispute previously before the Commission concerning ORI's eligibility for a Standard Offer 2 (SO2) agreement. The settlement consists of a settlement agreement and a restated power purchase agreement (collectively, the Settlement Agreement) with terms based on SDG&E's SO2 as reinstated for a block of 182 MW of capacity in 1989, Decision (D.) 89-02-017, 31 CPUC 13.

Background

ORI approached SDG&E in 1985 seeking a SO2 power purchase agreement for a proposed cogeneration plant in Oceanside, California. A dispute arose between SDG&E and ORI as to whether ORI had timely accepted the SO2 and whether ORI would be able to change the project site.

In February of 1987, ORI filed a complaint (Case (C.) 87-02-018) with the Commission requesting that it order SDG&E to enter into the SO2 and to permit the requested site change. The assigned Administrative Law Judge (ALJ) urged the parties to settle the dispute. However, since negotiations were initially unsuccessful, ORI instituted litigation in the San Diego County

Superior Court, and the Commission dismissed the complaint case without prejudice (D.90-01-047).

Further intensive negotiations yielded the Settlement Agreement for which SDG&E now seeks approval. The Superior Court lawsuit has been stayed to permit the parties time to obtain Commission approval.

Summary of Settlement Agreement

The Settlement Agreement provides ORI with a modified purchase agreement which SDG&E asserts is better for SDG&E and the ratepayers than is the disputed SO2. The key terms of the Settlement Agreement are:

Price

Under the Settlement Agreement, the capacity price varies based on when ORI supplies capacity. SDG&E will not pay for any capacity supplied prior to May 1, 1994. Thereafter, SDG&E will pay for as-available capacity at the published as-available rate until the project passes its firm capacity test. Once the project is firm, it will receive a firm capacity price based on the particular year involved:

For Firm Capacity Provided in	The Price Will Be
1994 (after May 1)	$148/kw-yr
1995 (calendar year only)	156/kw-yr
1996 (calendar year only)	165/kw-yr
1997 and thereafter	172/kw-yr

These prices are based on a term of 30 years. In contrast, the higher SO2 prices ORI sought in the disputed SO2 were only for a 25-year term.

SDG&E asserts that these prices represent a substantial present value benefit as compared to performance under the disputed SO2. In fact, the capacity price is very near the price in the

Reinstated SO2 which SDG&E made available in 1989 pursuant to D.87-11-024 and D.89-02-017.

Curtailment Rights

Under the Settlement Agreement, the energy price is based on published avoided cost, except during periods of curtailment when it is based on SDG&E's system decremental cost. In contrast, the disputed SO2 paid published avoided cost for all hours and did not provide for a special, lower curtailment energy price.

The Settlement Agreement gives SDG&E over 1,800 hours of economic curtailment rights each year, with as many as five hours each day (from 12 a.m. to 5 a.m.). Under this provision, if SDG&E requests curtailment, ORI must either (i) curtail its energy deliveries during the hours SDG&E requests it, or (ii) continue to deliver to SDG&E but receive only SDG&E's expected system decremental cost for the period. This rate will approximate SDG&E's cost of economy energy. SDG&E asserts that the curtailment rights provide it with energy savings on a net present value basis of approximately $3.5 million in 1991 dollars.

General Contract Terms

Under the Settlement Agreement, the disputed SO2 is completely revised to conform generally with the Reinstated SO2 used for SDG&E's last SO2 solicitation.

Milestones

The disputed SO2 contained no performance milestones. In 1988, the Commission endorsed a new SO4 which included "rigorous development milestone requirements." (D.88-03-079, mimeo. at p. 38.) The Commission approved the same milestone requirements for SDG&E's reinstated SO2 (D.87-12-056, mimeo. at pp. 3-4). The Settlement Agreement incorporates similar milestone requirements. These milestones allow for monitoring the progress of project development through quarterly reporting. They provide greater assurance of performance and protection in the event of

nonperformance. If ORI fails to meet a milestone, SDG&E may terminate the purchase contract and is free to find alternative supply sources to replace ORI.

Description and Details of Project and Project Schedule

The milestones are tailored to reflect the unique circumstances of this project. Because of the way the dispute has evolved and the time that has passed, ORI no longer possesses control of the original site.

To achieve a settlement, ORI has investigated alternative sites. However, because the Settlement Agreement was necessarily conditioned on Commission approval and because the Settlement Agreement was only executed on December 4, 1990, ORI has not had the time to finalize site control arrangements. ORI has represented to SDG&E that it does not believe it would be prudent to risk funds to commit to a site until the Commission approves the Settlement Agreement, particularly given expenditures it previously has made for its original site. Thus, SDG&E asserts that in order to fashion a settlement, it was necessary to balance ORI's needs, to wait to finalize site plans until after Commission approval, with SDG&E's needs, to obtain a firm commitment from ORI.

This type of balancing was very important to SDG&E. In order that this project not become "a contract in search of a project," SDG&E obtained contract provisions that offered adequate safeguards against potential project brokering while still taking into account the circumstances that have resulted in ORI currently not possessing site control. It appeared to SDG&E that only if a balance could be achieved would a settlement be possible.

The Settlement Agreement achieves this balance through a variety of means. ORI must possess site control, post its Project Fee and pay for the cost of the detailed interconnection study within two years of Commission approval. It must specify the precise capacity of the project within one year of Commission approval, and is permitted to reduce, but not increase, the

capacity by up to 10 MW within two years of Commission approval. Thus, the Settlement Agreement permits some schedule leeway for ORI to finalize site control.

Counterbalancing this, the parties agreed to some milestones stricter than in the Reinstated SO2; the disputed SO2 had no protective milestones at all, other than the five-year deadline. Under the Settlement Agreement, ORI must pay the cost of, and provide information to conduct, the detailed interconnection study not later than two years after Commission approval. In contrast, in the Reinstated SO2, the detailed interconnection study is not tied to contract execution at all. By modifying this milestone, SDG&E protects against ORI pursuing a speculative project. If ORI waits until the 24th month after Commission approval to obtain site control, it will only be able to supply the information for a detailed interconnection study if it had previously completed substantial design work. This stricter milestone forces ORI to progress with its project promptly.

The milestones also require initial operation and firm operation sooner than under the Reinstated SO2. Under the Reinstated SO2, the developer must begin operation within five years of contract execution. Under the Settlement Agreement, ORI must begin operation within four and one-half years of Commission approval. Under the Reinstated SO2, a developer could have as long as six years from contract execution to become firm. Under the Settlement Agreement, ORI must establish firm operation within five years of Commission approval.

The Settlement Agreement also removes the price incentive to delay a project that exists under a more traditional SO2. ORI has price incentives to begin operation sooner. Under the original SO2, a developer receives a levelized price based on the year operation begins. The developer receives the indicated price each year of operation. If the developer under a 30-year contract delays operation a year, it receives a higher price each year of

its 30-year contract. Under the Settlement Agreement, the price for each year of operation is fixed. If ORI delays operation, it simply loses that year's price benefit. The present value cost of capacity if operation is delayed until 1997 is over $14 million less than if it begins in 1994. Thus, if ORI's project is speculative, but it still meets its development milestones, ORI pays for the speculative nature of its project.

ORI represents that it is already proceeding to develop its project with an ice arena as a thermal host. However, it is also looking at other alternatives in the event that its first choice proves infeasible due to permitting, economics or other reasons.

Location Restriction

The Settlement Agreement limits the portions of SDG&E's system that ORI can connect with to avoid adverse impact on SDG&E's ability to import bulk power. This provision, which has not been included in the standard offers to date, enables SDG&E to avoid potential adverse consequences that could affect its system if ORI sought to interconnect in certain locations.

Preliminary Study Costs

Under the Settlement Agreement, SDG&E will perform, at no cost to ORI, up to three preliminary interconnection studies for ORI.

Benefits of Settlement Agreement

Capacity Cost

Based on SDG&E's calculations, the Settlement Agreement has substantial capacity cost benefit as compared with the disputed SO2. A summary of SDG&E's calculations is set forth below:

Comparison of Benefits

	Cost Under Disputed SO2 Capacity Table Operation Beginning in 1994 (NPV 1991 $)	Settlement Agreement Operation Beginning in 1994 (NPV 1991 $)
	(a)	(b)
Contract Term	30 years	30 years
Cost of 41 MW of Firm Capacity	$50.7 mm	-
Cost of 9 MW of As-Available Capacity	$ 8.4 mm	-
Total Cost of 50 MW of Capacity	$59.1 mm	$53.2 mm
Less: Energy Savings	0	(3.5 mm)
Total Cost of Capacity Net of Energy Savings	$59.1 mm	$49.7 mm

(in 1991 dollars)

Notes

1. Column (a) shows firm capacity costs based on the disputed SO2 adjusted to reflect: a contract term of 30 years rather than 25 years, 9 MW of additional capacity to make up the total of 50 MW reflected in the Settlement Agreement, and plant operation beginning in 1994 rather than 1988.

2. Column (b) shows firm capacity costs based on the Settlement Agreement which specifies a 30-year contract term, 50 MW of capacity, and plant operation commencing in 1994.

Thus, under the Settlement Agreement, based on SDG&E's analysis, the capacity cost savings would be roughly $9 million on a net present value basis in 1991 dollars.

In addition, in its application, SDG&E sets forth other economic scenarios which reflect even greater savings based on various assumptions. We find no need to discuss these scenarios.

Curtailment Value

As discussed above, the Settlement Agreement provides energy savings through curtailment rights, which SDG&E estimates at $3.5 million in 1991 dollars.

Comments of the Parties

This application, requesting ex parte treatment was served on all parties to SDG&E's Energy Cost Adjustment Clause (ECAC) proceeding, which includes adjacent electric utilities, qualifying facilities and consumer organizations. There was no opposition to the request.

However, the Division of Ratepayer Advocates (DRA) filed comments stating that although DRA does not find the terms of the Settlement Agreement or the amended power purchase agreement to be unreasonable, it is concerned with the scope of approval requested in the application. The application requests, among other things, that the Commission issue an order:

> "Finding that costs incurred under the Restated Power Purchase Agreement are reasonable and SDG&E may recover them in its ECAC proceeding." (Application at p. 20.)

DRA agrees that an application is the appropriate procedure for requesting approval of a settlement agreement and amendments to a power purchase agreement. However, according to DRA, granting the relief requested would amount to forfeiture of the Commission's right to review the reasonableness of SDG&E's performance and administration of its obligations and exercise of its rights under the amended power purchase agreement. In effect,

the application requests the Commission to find that costs not yet incurred are reasonable.

DRA points out that while it is appropriate to determine the reasonableness of the terms of an agreement at this juncture, there is no record to support a finding that costs incurred are reasonable -- they have not yet been incurred. The actual costs incurred or payments made under the terms of the approved agreement can only be reviewed after they are made, such as in the ECAC proceeding. And DRA argues that these costs and payments are all part of contract administration which the Commission has consistently reserved for later ECAC review. (See, for example, D.91-06-050.)

Discussion

We need to decide three questions: whether the Settlement Agreement meets the requirements of the Commission's Rules of Practice and Procedure, Rule 51 et seq.; whether the terms of the Settlement Agreement are permissible under the principles enunciated by the Commission which govern the administration of such contracts; and whether recovery in rates by SDG&E of payments to ORI under the power purchase agreement should be subject to the Commission's Reasonableness Review Procedure.

Rule 51.1(c) permits parties to propose a stipulation or settlement for adoption by the Commission.[1] Under Rule 51.1(e), the Commission "will not approve stipulations or settlements, whether contested or uncontested, unless...reasonable in light of

1 Rule 51 et seq. may not apply to this case because SDG&E's application seeks approval of a settlement that SDG&E and ORI arrived at outside of a Commission proceeding. We will nevertheless apply the analysis required by Rule 51 et seq. to this case. SDG&E's application is an extension of C.87-02-018, which was dismissed without prejudice and thus could be refiled if the settlement is not approved, and the pending litigation between SDG&E and ORI in Superior Court.

the whole record, consistent of law, and in the public interest." The effect of Commission adoption of the settlement is that it becomes binding on all parties to the proceeding. However, under Rule 51.8, unless the Commission expressly provides otherwise, adoption of the settlement "does not constitute approval of, or precedent regarding, any principle or issue in the proceeding or in any future proceeding."

Essentially, our concern is whether the Settlement Agreement is in the public interest.

SDG&E's application sets forth a detailed economic analysis that shows that the Settlement Agreement provides SDG&E and its ratepayers with price and contract terms substantially better than those contained in the disputed SO2 that SDG&E declined to enter. According to SDG&E, the Settlement Agreement provides capacity cost savings of $9 million and energy savings through curtailment rights of $3.5 million in 1991 dollars. While these figures are based on certain assumptions, which SDG&E sets forth in its analysis, neither these assumptions nor SDG&E's estimate of savings has been disputed by any party. In fact, DRA takes no exception to SDG&E's estimate of savings.

Regarding conformance with contract principles currently approved by the Commission, SDG&E asserts that the firm capacity price under the Settlement Agreement "is very near" the price in the SO2 that the Commission reinstated (D.87-11-024, pp. 40-41; D.89-02-017).

The application states that under the Settlement Agreement capacity prices between 1994 and 1997 would increase from $148/kw-yr to $172/kw-yr, and be levalized at $172/kw-yr for the remainder of the 30-year period. In contrast, under the Commission's Reinstated SO2, a plant that qualified for service in 1994 would receive capacity prices of $148/kw-yr and would remain at that level for the remainder of the 30-year period. Therefore,

under the Settlement Agreement, compared with the Commission's Reinstated SO2, ORI is receiving a small premium.

On balance, we conclude that the small premium is reasonable since the outcome of pending litigation in the Superior Court could go against SDG&E, and since SDG&E's ratepayers are benefitting to the extent that they do not have to pay for capacity that is not needed. According to SDG&E, the ratepayers would have paid between $5 million and $36 million more (on a present value basis) for power, during a period when SDG&E had no need for that power.

Further, we believe that the Settlement Agreement is consistent with Commission policy addressing QF/utility disputes. The Commission has previously emphasized the further benefit provided by eliminating the risk and uncertainty of such disputes and pressing forward with productive business relations between QFs and utilities:

> The Commission has strongly encouraged negotiated resolution of disputes between utilities and qualifying facilities. There are several policies that are furthered by such negotiations. One often-over looked policy is that settlements are often preferable, from a societal standpoint, to adjudication. A tribunal must generally reach an all-or-nothing result, with losses or even bankruptcy for one of the parties, whereas the parties themselves might have negotiated a result that both could live with.

(D.88-08-021, 28 CPUC 2d 582, 587, fn. 3, quoting ALJ's ruling of August 17, 1987.)

In summary, we are satisfied that SDG&E has aggressively negotiated on behalf of its ratepayers. Also, we are convinced that the renegotiated terms as set forth in the Settlement Agreement protect ratepayers' interests.

Lastly, with regard to the Commission's Reasonableness Review proceedings, we agree with DRA that administration of the

contract by SDG&E should be subject to annual reasonableness reviews, since the reasonableness of payments made by SDG&E for power can be reviewed only after they are made.

Findings of Fact

1. SDG&E and ORI have settled their dispute by renegotiating certain terms of their power purchase agreement, as set forth in the Settlement Agreement attached to SDG&E's application in this proceeding.

2. SDG&E estimates that the Settlement Agreement saves ratepayers approximately $3.5 million in energy costs through curtailment rights, and approximately $9 million in capacity costs through deferral of this project to a 1994 date of operation.

3. The capacity price of the renegotiated power purchase agreement closely approximates the price approved by the Commission in the Reinstated SO2 which the Commission recently made available to SDG&E.

4. It is in the interest of SDG&E and its ratepayers to settle the dispute with ORI rather than litigate the matter in Superior Court.

5. The small premium payable to ORI pursuant to the Settlement Agreement over the capacity prices set forth in the Commission's Reinstated SO2 is reasonable.

6. The settlement is not contrary to law, and is in the public interest.

Conclusions of Law

1. The settlement should be approved.

2. The pricing provisions of the renegotiated power purchase agreement set forth in the Settlement Agreement are reasonable and should not be subject to further reasonableness review by this Commission, but the Commission should be able to ascertain that the power purchase agreement is being administered prudently and that any payments are made in accordance with the terms thereof.

3. Payments that SDG&E properly makes pursuant to the pricing provisions of the Settlement Agreement should be deemed reasonable and recoverable in SDG&E's rates.

4. The Settlement Agreement and the renegotiated power purchase agreement dated December 4, 1990, should be approved.

5. Because SDG&E and ORI need Commission approval of the Settlement Agreement prior to dismissing the pending suit in the Superior Court, this decision should be effective on the date signed.

O R D E R

IT IS ORDERED that:

1. The settlement agreement and renegotiated power purchase agreement dated December 4, 1990, between San Diego Gas & Electric Company (SDG&E) and Oceanside Refrigeration, Inc. are approved and adopted.

2. The Commission's approval of the Settlement Agreement and renegotiated power purchase agreement is final and not subject to further reasonableness review, except as set forth below.

3. SDG&E is entitled to recover all payments properly made pursuant to the pricing provisions of the renegotiated power purchase agreement through SDG&E's Energy Cost Adjustment Clause or any other mechanism the Commission may establish that provides for full recovery of such payments.

4. Any recovery of payments under the renegotiated power purchase agreement is subject to the Commission's review of the

reasonableness of SDG&E's performance and administration of its obligations and exercise of its rights under the renegotiated power purchase agreement.

5. This proceeding is closed.

This order is effective today.

Dated September 25, 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