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Decision 96-07-047 July 17, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Edison Company (U 338-E) for Orders: (1) Approving a Proposed Settlement and Power Purchase Agreement Restructuring Between Edison and Daggett Leasing Corporation; (2) Authorizing Edison's Recovery in Rates of Payments Made Pursuant to the Power Purchase Agreement included in the Proposed Settlement and Restructuring; (3) Authorizing the Lease of 58 Acres of Real Property Including Limited Water Use to Luz Solar Partners, Ltd., Luz Solar Partners, Ltd., II, Solar Project Management, Inc., CP National Corporation, UCC-1985 Luz Solar II, and Solar Project Partners II, Ltd.; (4) Authorizing the Sale of 333 Acres of Real Property and Limited Water Use to Daggett Leasing Corporation; and (5) Authorizing the Grant of Easements to Daggett Leasing Corporation.	Application 95-10-020 (Filed October 3, 1995)

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O P I N I O N

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Summary

Southern California Edison Company (Edison) seeks approval of a settlement with Daggett Leasing Corporation (Daggett), an operator of two solar energy electric power generating stations, that involves amending and restating two existing non-standard power purchase agreements (PPAs), leasing utility property to third parties, some of which are affiliates of Daggett, selling that utility property to Daggett, granting easements over utility property to Daggett, and authorizing recovery of associated payments in rates.

Procedural Background

Edison is a public utility subject to the jurisdiction of the Commission. Edison filed this application on October 3, 1995. Notice of the application was given in the Daily Calendar on October 30, 1995. No protests were filed.

History of the Project to Date

The Power Purchase Agreements

In the beginning, Edison and Luz Engineering Corporation, a California corporation (Luz), entered into a Solar Energy Power Purchase and Sales Agreement on July 9, 1982. This agreement contemplated a 15 megawatt (MW) solar energy generating station to be constructed on property owned by Edison near Barstow, California. Edison and Luz amended that agreement on February 14, 1983 to increase the capacity of the project to 49 MW (as so amended, the Original Agreement).

On April 30, 1984 Edison and Luz Solar Partners Ltd., a California limited partnership (LSP), acting through its general partner Luz, entered into an "Amended Solar Energy Purchase and Sales Agreement Between Luz Solar Partners Ltd. and Southern California Edison Company" which recited that it amended and

superseded the Original Agreement between Edison and Luz.[1] This agreement (as further amended and restated, the SEGS I Agreement) provided for a 13.8 MW project and a 30-year term. On December 27, 1984, Edison and LSP, again acting through Luz, further amended and superseded the Original Agreement as amended and superseded on April 30, 1984, to amend certain provisions governing the calculation of payment. On June 14, 1985 Edison and LSP, through its general partner Luz, entered into an "Amended Solar Energy Purchase and Sales Agreement Between Luz Solar Partners Ltd. and Southern California Edison Company" which yet again recited that it amended and superseded the July 9, 1982 agreement between Edison and Luz as further amended February 14, 1983, April 30, 1984, and December 27, 1984 and further modified payment calculation provisions.

Not content with its disposition of the Original Agreement on April 30, 1984, Edison and Luz Solar Partners II Ltd., a California limited partnership (LSP II), acting through its general partner Luz, on the same date entered into an "Amended Solar Energy Purchase and Sales Agreement Between Luz Solar Partners II Ltd. and Southern California Edison Company" which also recited that it amended and superseded the Original Agreement between Edison and Luz.[2] This agreement (as further amended and restated, the SEGS II Agreement) provided for a 30 MW project over a 30-year term. Edison and LSP II amended the SEGS II Agreement on July 7, 1986 to adjust payment requirements for interconnection facilities' operation and maintenance and to describe the summer and winter seasons.

[1] Although Luz executed the June 14, 1985 amendment, it did so in its capacity as the general partner of LSP. The amendment does not contain a specific agreement by Luz to a novation of its agreement with Edison. We can only assume that the change to the interest of Luz in the subject matter of this contract was evidenced by other means.

[2] The apparent intent of the parties in dealing with the original Agreement was to divide it into two bundles. It would have been preferable if this had been made explicit.

The SEGS I project was operational on June 14, 1985 and the SEGS II project was operational on March 26, 1986.

On December 28, 1990 Edison approved the assignment to Daggett of the PPAs. The Commission found the execution of the PPAs reasonable in 1993. (In re Southern California Edison Company (1994) (Decision (D.) 94-05-058).)

The Leases and Entry Permits

On July 14, 1983, Edison leased 275 acres to Luz at a nominal rent in connection with the Original Agreement (the Ground Lease). Edison added 17 acres on August 14, 1985 for a base rent of $10,404 per year, with increases tied to the regional Consumer Price Index. Edison and Luz agreed to further amend the Ground Lease to reflect the different use of the property by SEGS I and SEGS II, but they never did so. Daggett currently subleases this property from Luz's successors in interest: LSP, LSP II, Solar Project Management, Inc., a California corporation (SPM); CP National Corporation, a California corporation (CPN); CPN Leaseco, a California corporation (Leaseco), UCC-1985 Luz Solar II, a California limited partnership (UCC), and Solar Project Partners II, Ltd., a California limited partnership (Solar) (collectively, the Lessees).

In addition to the Ground Lease, in 1985 Edison and Luz entered into temporary entry permits to connect the Ground Lease property to, and to use a 25-acre parcel for, evaporative ponds. These expired at some point, but are now the subject of a new temporary entry permit dated as of January 1, 1994 between Edison and Daggett.

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[1] An acre-foot of water equals 325,850 gallons.

Environmental Contamination

The projects use heat transfer fluids which have contaminated the soil, along with other chemicals. The cost of the environmental remediation that will be required by applicable law has not be determined. Daggett estimates that the cost of clean-up will be approximately $2 million; Edison believes the cost could be as much as $4 million. The Ground Lease does not contain any express agreement concerning environmental remediation.

Water Rights

The Ground Lease permits the extraction and use of up to 1,000 acre-feet[3] of water per year for operation of the projects. Regional water rights are the subject of pending litigation involving the major water users in the Mojave River basin, including the Barstow and Victorville area. Edison is a party to that litigation. A proposed stipulated judgment to the litigation would result in a decrease of approximately 32% in Edison's water rights (from 4,565 acre-feet of water per year to 3,100 acre-feet per year) over an eight-year period. In addition, pumping and usage fees would be imposed at approximately $2.50 per acre-foot. Edison uses its water rights for its Cool Water Generating Station and adjacent solar research facilities in addition to providing water under the Ground Lease. Edison anticipates that its water allocation will be insufficient to support all foreseeable uses. The Ground Lease does not specifically address any pro rata reduction in the right to extract and use water in such event.

Differences Among the Parties

As early as 1987 Edison and Daggett's predecessors began to discuss further changes to the SEGS I and SEGS II

[3]An acre-foot of water equals 325,850 gallons.

Agreements. Those discussions did not result in any agreement until March 17, 1995, when the parties entered into agreements to reform the PPAs, the Ground Lease, the temporary entry permits, and to provide for certain property transfers (collectively, the Reformation Agreements). The Reformation Agreements would resolve a number of outstanding disputes concerning the basis for payments under PPAs, a waiver from the Federal Energy Regulatory Commission (FERC), provisions for environmental remediation, payments for past use under expired temporary use permits, and whether certain claims are time barred.

Basis for Payment under the PPAs

Heat Rate Values

Payment under the PPAs depended, in part, upon Edison's Avoided Cost, defined as "the product of Edison's system heat rate of its Los Angeles Basin fossil fuel generating plants (thermal system) during on-peak, mid-peak, and off-peak hours" and Edison's cost of fuel, calculated as provided in the PPAs. Edison and Daggett agree that "Edison has always based the heat rate value ... using a 1984 heat rate, since it is the most recent heat rate published." Daggett, however, claims that the PPAs "provide that the system heat rates of Edison's Los Angeles Basin fossil fueled generating plants ... could and should have been periodically updated to reflect changes in Edison's system."

Incremental Heat Rate

Edison and Daggett also agree that Edison "has always calculated the incremental heat rate under the [PPAs] by using 91% of Edison's average heat rate." In its prepared testimony, Edison explains that in calculating Avoided Cost it has applied a historical ratio of incremental heat rates to average heat rates to its system average heat rate, rather than simply using an average heat rate. Edison does not explain what it means by

"incremental heat rates" but "contends that this practice was agreed to by Daggett's predecessors."

Exclusion of Combustion Turbine and Combined Cycle Units

A third payment related issue is whether combustion turbine and combined cycle units should have been, and be, included in the scope of the Los Angeles Basin fossil fuel generating plants used to determined Avoided Cost. Edison has excluded such units and contends that it has done so with the agreement of Daggett's predecessors.

Oil-to-Gas Conversion Factor

Edison maintains that it has always applied a factor of 1.035 to convert oil based heat rates to gas based heat rates in calculating payments under the PPAs. Daggett claims, however, that Edison has used inconsistent factors.

Use of Operation and Maintenance and Line Loss Factors

The parties agree that Edison has not calculated its avoided cost based on any portion of Edison's operation and maintenance costs or any factor to account for line losses. Edison's position is that the PPAs do not so provide. Daggett's position is that these factors are necessary to reflect Edison's avoided costs properly.

Use of Proxies for Oil and Gas Costs

Payment under the PPAs depended, in part, upon the product of Edison's system heat rate and "Edison's cost of fuel oil purchased in the previous quarter or the most recent quarter prior thereto providing said oil is the fuel displaced. [However, if energy produced under the PPA does not displace fuel oil, the product of the heat rate and] the recorded average cost of fossil fuel Edison utilized to produce electricity in Los Angeles Basin power plants as established during the previous quarter." From December 1988 through August 1991, Edison

calculated energy payments under the PPAs using published oil and gas price indices rather than its actual costs.

Status of an Amended Agreement to Guarantee

On June 14, 1985 Edison, Luz, Luz Industries (Israel) Ltd., and Luz International Limited amended and superseded an "Agreement to Guarantee" related to the PPAs (as amended and restated, the Amended Guarantee). The Amended Guarantee contemplated that Edison might pay more to LSP under the SEGS I Agreement than its avoided cost and that the projects under the PPAs might not be fully operational when expected.

The Amended Guarantee provided for an escrow arrangement into which payments would be deposited based on the amount by which Edison's payments under the SEGS I Agreement exceeded Edison's avoided cost as defined therein plus interest. Obligations under the Amended Guarantee were secured by a grant of security interest to Edison in certain amounts due in connection with financing of the projects.

It is not clear precisely how Daggett succeeded to the obligations imposed by the Amended Guarantee, but the parties agree that all of its obligations were discharged as of December 31, 1993 and that no further liabilities exist. The parties agreed to terminate the Amended Guarantee.

FERC Waiver

Under the Public Utility Regulatory Policies Act of 1978, as amended (PURPA), and the regulations adopted by FERC thereunder, electric utilities such as Edison are required to purchase electricity from qualifying facilities (QFs). (See New Charleston Power I, L.P. v. FERC (1995) 56 F.3d 1430, 1432 (2d Cir.).) QFs also enjoy exemption from important aspects of the

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[1] This was due to a change in Southern California Gas Company's tariff that imposed a demand charge which resulted, in Edison's view, in a substantial overstatement of energy costs in certain circumstances.

Federal Power Act, the Public Utility Holding Company Act, and most state regulations. (Stephen Ferrey, Law of Independent Power (1995) § 4.02[1].) Under FERC regulations, to maintain its favored status as a QF[5], Daggett must use biomass, waste, renewable resources, or any combination, for at least 75% of its total energy input and it may not use oil, natural gas, or coal for more than 25% of its total energy input. (See New Charleston, 56 F.3d at 1432.)

Daggett found itself wanting relief from this requirement:

> After Mount Pinatubo erupted in June 1991, there was a sharp drop in solar radiation in the Western United States. *See Daggett Leasing Corp.*, 64 F.E.R.C. ¶ 62,148, at 62,175, *reh'g denied*, 65 F.E.R.C. ¶ 61,143 (1993). Solar-powered electrical generating facilities asked [FERC] to waive the 25 percent rule because of the large aerosol cloud impeding their production of electricity and threatening their financial viability. [FERC] granted the requests, allowing the companies to exceed the fossil fuel limit for 120 days, by which time the cloud was expected to dissipate. *Daggett Leasing Corp.*, 64 F.E.R.C. at 62,128; [other citations omitted].

(New Charleston, 56 F.3d at 1433.)

In the event, however, Daggett has not exercised its rights under the waiver it obtained from FERC. Daggett claims that it still retains a right to use the waiver, while Edison maintains that either the 120-day time allowed has passed or that if it has not passed, the right is of little practical value because of applicable air emissions regulations and the physical production capability limitations of the SEGS I and SEGS II facilities which would require the addition of expensive new equipment. In the Settlement Agreement, Daggett agreed to relinquish its rights under the FERC waiver.

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[5]The PPAs do not appear to depend on LSP and LSP II remaining QFs since there is no covenant regarding QF status.

Environmental Remediation

The parties agree that the SEGS I and SEGS II projects are located on land owned by Edison and that the soil may have been contaminated to an extent requiring potentially expensive remediation measures. Edison claims that Daggett is responsible for the cost of remediation, while Daggett disclaims any contractual obligation to Edison with respect to any environmental damages that may have occurred. As discussed below, however, Daggett proposes to purchase the affected property, and to assume "full liability for environmental remediation." Since, in Daggett's view, it is not already contractually liable for such costs, undertaking them is of value to Edison.

Payment for Past Use Under Expired Temporary Entry Permits

Daggett occupied a portion of Edison's property, for an evaporative pond and a pipeline corridor, for several years without any formal arrangement or payment. Daggett claims that Edison consented to such occupation and no payment is due.

Statute of Limitation and Course of Dealing

Edison takes the position that Daggett's claims against it under the PPAs are time barred by the statute of limitation or under the doctrine that ambiguous terms in a contract may be explained by the course of dealing between parties. Daggett's position is that the statute of limitation "does not apply because, among other reasons, Edison has only recently provided Daggett with information on which to base its claims."

The Price Tag Associated with These Issues

Naturally, these issues could result in differences in the amounts that should have been paid in the past and should be paid in the future under the PPAs. Edison estimates the effect

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of these issues, if resolved adversely to its positions, as follows:

Issue	Past Payments[6]	Remaining Payments[7]	Total
Heat rates	$1.8 million[8]	$3.0 million	$4.8 million
Incremental heat rate	$2.0 million	$2.5 million	$4.5 million
Type units	$0.1 million	--	$0.1 million
Oil-to-gas factor			$0.065-$0.39 million
O&M Adder	$2.3 million	$1.5 million	$3.8 million
Price proxies			$0.6 million
FERC Waiver	--		$0.6-$3.0 million
Environmental Remediation			$0 - $4.0 million
Water purchases			$0 - $2.1 million
TOTAL			$14.5-$23.3 million

Proposed Settlement of the Differences

Edison and Daggett agreed to compose their differences by entering into a series of agreements pursuant to a Settlement Agreement dated as of March 17, 1995 (the Settlement Agreement).

[6] Through December 31, 1993.
[7] From January 1, 1994 through December 31, 2014.
[8] All estimates, unless otherwise stated, are based on net present value at January 1, 1994 at an 11% discount rate, including, in the case of past

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Temporary Entry Permit

Edison and Daggett entered into a Temporary Entry Permit dated as of January 1, 1994 to provide for the "[o]peration, use, maintenance, repair, construction and reconstruction of water evaporation ponds and existing pipelines connecting such points to the SEGS I and SEGS II solar electric generating facilities and access to said ponds and pipelines site." The term of the Temporary Entry Permit is indefinite, extending until the earlier of the lease or sale of the described property to Daggett. Daggett agreed to indemnify Edison against broadly defined contingencies and to maintain liability insurance in the amount of $2 million. Daggett also agreed to pay an annual fee of $3,750 for use from January 1, 1994 and $25,000 for past use, payable in two equal installments (on execution and on Commission approval of the Settlement Agreement, the replacement agreement for the PPAs, and the amendment to the Amended Ground Lease).

Replacement PPA

As it was in the beginning, the PPAs are to be reunited in a "Combined, Amended, and Restated Power Purchase Agreement" between Daggett and Edison (Replacement PPA).[9] The Replacement PPA is based on a Standard Offer No. 2 form (SO2) and is made effective as of January 1, 1994.

The Replacement PPA is between Edison and Daggett in its own capacity, rather than as general partner of either LSP or LSP II. It combines the SEGS I Agreement and SEGS II Agreement. Because it is based on the SO2 form, it contains a covenant that each of the projects remain QFs, considered independently. The Replacement PPA eliminates special provisions excusing

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underpayments, if any, interest at an approximate rate of 1.25% per month. Consistent with the handling of the June 1984 amendment, the Replacement PPA does not explain what became of LSP and LSP II.

nonperformance for "deemed emergency" conditions with respect to the agreed availability factor. No change in the term will occur. Edison relinquishes its right of first refusal to purchase the projects under certain circumstances. General payment terms are brought under the SO2 regime, including "deration[10]," and are to be applied retroactively to January 1, 1994.[11]

Capacity payments are set at $140/kW/year, calculated using the usual SO2 formula. Bonus payments are not SO2-based, but reflect a Joint Stipulation of Edison and Luz and Motion for Order Approving Settlement and Dismissing Petition for Modification of Decision No. 87-12-066.[12] Daggett has the option of increasing the firm capacity under the Replacement PPA by 1 MW in each of 1996, 1997, 1998, and 1999.

Under the Replacement PPA, Edison is to pay for energy delivered based on time of day usage (peak, mid-peak, off-peak, and super off-peak) multiplied by a rate, initially equal, as of January 1, 1994, to 80% of Edison's published avoided cost. Thereafter, the Replacement PPA ties energy prices to changes in

[10] "Deration" is not defined in this sense in the dictionary (*see, e.g.*, The Compact Oxford English Dictionary 495 (1991 2d ed.) ("to free (a rationed commodity) from rationing"). It is apparently intended to nominalize the verb "derate," which is an engineering term meaning to lower the rated capability of an apparatus due to deterioration or inadequacy. In the SO2 form of power purchase agreement, Edison agrees to pay a QF a fixed payment per kilowatt capacity made available in any year. In the event that the facility fails to deliver the contractual firm capacity, and in certain other circumstances, the seller may be liable to Edison contractually for the difference between the contracted firm capacity and the actual firm capacity. In such event, Edison may be entitled to reduce the firm capacity of the contract (to "derate" it) and to recover the cumulative difference between amounts paid and amounts that would have been due at the reduced rate by way of curtailment.

[11] Payments are being made under the current scheme, and a true-up would be performed on Commission approval of the Replacement PPA.

[12] See In re Southern California Edison Company (1988) 28 CPUC2d 15, 16, in which we modified D.87-12-066 with respect to marginal cost, revenue allocation, and rate design elements of an order authorizing Edison to file new electric rates. We did not review the petition of Luz that sought "clarification that Edison was not authorized in D.87-12-066 to modify its method of calculating avoided capacity cost bonus payments to qualifying facilities." (Id.) We deferred action on Luz's petition until April 15, 1988, when Edison was to report the results of its negotiations with Luz. It

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Edison's published price schedule for QF purchases and the rate of inflation (per the gross-domestic-product deflator) using a formula. In any year, 25% of the change in rate will be determined solely by reference to Edison's published avoided cost for the time of day corresponding to usage. The remaining 75% of the change will be determining by applying an escalation factor to the respective 1994 published rates. That escalation factor is the lesser of the applicable Gross Domestic Product Implicit Price Deflator index of inflation as a ratio of the 1994 index or the ratio of Edison's published avoided cost for 1994 and the current period. The effect of this formula will be to modulate the rate of change of Edison's published costs.

Environmental Agreement

Edison and Daggett entered into an Environmental Remediation and Indemnification Agreement on March 17, 1995 (Remediation Agreement). Daggett acknowledges that it is the operator of, and has control over, the SEGS I and SEGS II solar generating facilities, the evaporative ponds, and other associated facilities. Daggett agrees to perform an environmental assessment of the property and any other property that may have been affected by the operation of the facilities, including a determination of the existence and extent of contamination. Daggett also agrees to develop and implement a plan to remediate any soil or groundwater contamination. Edison has the right to approve Daggett's environmental consultant and to comment on the environmental assessment and remediation plan. Daggett is to present the remediation plan to any regulatory or governmental agency whose approval is necessary for implementation of the" remediation plan. It is not clear which agencies these are. Daggett will implement the remediation plan and keep the property in conformity with applicable groundwater

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does not appear that the Commission took up the issue again

and soil contamination standards at its own expense. Daggett agrees to hold harmless and indemnify Edison, its parent, shareholders, officers, directors, employees, agents and attorneys from and against all claims, liabilities, fees, fines, penalties, forfeitures and losses for death, injury, or damage to property (other than diminution of value) in connection with Daggett's or its predecessors' use of the property before March 1995.

Sale Agreement

Edison and Daggett entered into a Sale Agreement for the transfer of 333 acres and certain easements, subject to the approval of the Commission. This is all of the property used by the projects, the evaporative ponds, and the corridors between them. Daggett is to pay Edison $103,000 and Edison is to convey to Daggett a grant deed in fee (subject to Edison's reservation of water and mineral rights with limited rights of entry for such mineral rights), a substation easement, various access easements, a solar easement, and a condition that the property be used solely for the purpose of operating solar electric generating projects). Daggett is to obtain the surrender of existing leases on the property, presumably meaning the interest of the Lessees.

Option Agreement

Edison and Daggett entered into an Option Agreement as of March 17, 1995 under which Edison has an option to repurchase the property within 120 days of certain events, including termination of the Replacement PPA, abandonment of the projects

We will not impose the condition that Daggett secure its obligations under the Remediation Agreement by a bond or similar arrangement. Edison will have the right to offset against the Replacement PPA payments in certain circumstances in connection with Daggett's performance under the Remediation Agreement. As that source of protection for the ratepayers diminishes with time, prudence dictates that Edison be vigilent that no unreasonable delay be tolerated in carrying out the obligations under the Remediation Agreement.

or the sale of the property to third parties at fair market value plus certain expenses.

Water Use Agreement

Edison and Daggett entered into a Water Use Agreement dated as of March 17, 1995. Edison agrees to allow Daggett to use water from a 2,400-acre site owned by Edison (commonly known as the Cool Water Ranch and Cool Water Generating Station) in an amount generally equal to Edison's water allocation less its actual use. The Water Use Agreement terminates when the Replacement PPA terminates, Edison reacquires the property sold by the Sales Agreement, and on certain other events.

Amendment to Ground Lease

Edison, Daggett, and the Lessees entered into the Amendment No. 2 to Amended Ground Lease and Consent dated as of March 17, 1995 (Amended Ground Lease). The Amended Ground Lease deals with the same property as the Sales Agreement and the Option Agreement and brings the project site under a single property regime. It is apparently intended as an interim arrangement pending consummation of the Sale Agreement.

Economic Analysis of the Settlement

Edison and Daggett have been negotiating over the allocation of up to $23.3 million, representing the difference between what Edison admits it is contractually obligated to pay, and what the parties agree that Edison might have to pay to

- Daggett under the PPAs[14]
- Third parties for water that Edison may be obligated to provide to Daggett

[14] "Net of a minor amount that Daggett may, or may not, be obligated to pay by way of back rent.

- Third parties for environmental remediation that Edison may be liable for as owner of the property

It will be useful to keep in mind the following chart, which shows how that amount might be allocated:

Potential Gains	Potential Losses
Edison	
None	$23,300,000
Daggett	
$17,200,000	$6,100,000

For its part, Edison stands to incur substantially more expense than it believes the PPAs commit it to pay to Daggett and benefits not at all from the outcome of the process. Daggett, on the other hand, is potentially liable for environmental remediation expenses and may incur costs to purchase water while standing to receive substantially more revenue under the PPAs if it prevails on its interpretation. Therefore, from Edison's perspective, the Settlement Agreement is a matter of damage control and from Daggett's perspective, the Settlement Agreement is only partially about damage control[15], but primarily about revenue enhancement.

Edison and Daggett agreed to adjust their differences as follows:

- Daggett would indemnify Edison against the costs of environmental remediation[16]

[15]With respect to environmental remediation, if it is determined that Daggett was a responsible party for contamination on the property, it is liable for the expense of remediation whether or not it is also indemnifying Edison. Daggett's main area of exposure is for water purchases if it does not prevail on its claim that Edison is obligated to provide it with water under existing arrangements.

[16]With the effect that Edison saves up to an estimated $4 million

- Edison would provide Daggett with water pursuant to the Water Agreement[17]
- Edison would sell required property to Daggett for a nominal amount[18]
- Edison would pay Daggett $9.154 million (the Settlement Amount) more under the Replacement PPA than under the existing PPAs

Edison and Daggett agreed to a set of assumed conditions concerning future inflation rates, gas prices, avoided cost energy prices, and power production from the projects. Some of these assumptions differ from the assumptions that Edison would otherwise apply, presumably as a result of bargaining. Under these assumptions, Edison and Daggett calculated that payment for firm capacity in the Replacement PPA at the rate of $107.60/kW/year would produce the same net present value payment stream[19] as the existing PPAs under Edison's interpretation. Increasing the firm capacity payment rate to $140/kW/year results in payment of the Settlement Amount from Edison to Daggett.

The calculation of this adjustment is, naturally, more complex than outlined. Edison and Daggett examined a range of assumptions regarding conditions under which the net present value of the existing PPAs could differ. If, for example, gas prices increase at a faster rate than assumed at a time when general inflation is lower than assumed, the Replacement PPA would result in projected increased payments of only $3.0 million. On the other hand, if gas prices turned out lower than forecast at a time when the increase in inflation was equal to or

[17] With the effect that Daggett or Edison saves up to $2.1 million in open-market purchases of water.
[18] The proceeds would be insufficient to cover the sum of the existing book value and the costs of sale, so Edison would actually incur a loss of approximately $119,000, which is partially offset by $25,000 for settlement of back rent issues.
[19] To January 1, 1994 at 11%.

greater than the escalation rate in avoided costs, the Replacement PPA would result in projected increased payments of $15.2 million.

When combined with the net effect of the property issues, the overall range of outcomes is that the Settlement Agreement results in a net transfer from ratepayers to Daggett of $3.1-15.6 million, with Edison estimating the most likely outcome to be $9.3 million. Putting a brave face on these numbers, Edison points to the corresponding range of possible outcomes of litigating the dispute, which it estimates as an expense to ratepayers of from $0.4-23.3 million, with the "median case" outcome estimated at $11.9 million. Putting together the costs of settlement with the potential outcomes results in the following matrix:

Cost of litigation*	Settlement Benefits (Costs)* High $ 15.6	Base $ 9.3	Low $ 3.1
Edison prevails $ 0.4	A (15.2)	B (8.9)	C (2.7)
"Median case" $ 11.9	D (3.7)	E 2.6	F 8.8
Daggett prevails $ 23.3	G 7.7	H 14.0	I 20.2

*in millions

The nine possible outcomes combining what could happen in litigation with what could happen if the determinants of pricing unfold in different ways represent the "benefits" of the Settlement Agreement to Edison's customers. In the outcomes marked A, B, C and D, customers are worse off than if Edison had taken its chances in litigation. In outcomes E, F, G, H, and I, customers are better off.

Jurisdiction

Edison seeks Commission approval of the Settlement Agreement and the transactions contemplated thereby "pursuant to Sections 701, 761, 851 and 2821, et al. of the [PU Code], the

Commission's Rules of Practice and Procedure, and prior decisions, orders, and resolutions of the Commission." This application falls under PU Code Sections 2821(a) and 851.

The jurisdictional basis for exercise of the Commission's authority over this matter is to be found in PU Code Section 2821(a), which requires us to "approve and establish equitable charges to be paid by an electrical corporation which purchases electricity or electrical generating capacity, or both" from a QF and in PU Code Section 851, which governs transfer of utility property.

As we have previously noted, when a utility presents a contract modification to us for our approval, it does so "for the purpose of assuring that costs stemming from the revised contract will be passed through in rates." (In re Investigation on the Commission's Own Motion into the Transmission System Operations of Certain California Electric Corporations Regarding Transmission Constraints on Cogeneration and Small Power Production Development (1992) (D.92-02-014).) In so doing, we normally consider the merits of the underlying contract dispute to assess the extent to which the settlement reflects the risks that would have been borne by each party had the dispute been litigated. (Id.) The degree of scrutiny that we employ ought reasonably depend on whether the underlying contract is on a form that we have previously prescribed or the product of negotiation between the parties that has departed substantially from our model.

The review under PU Code Section 851 is the general public interest standard.

Analysis of the Replacement PPA

Recapitulation

It has been Edison's negotiation position with Daggett that the most that Daggett could hope to recover from litigating

the PPAs and related agreements is approximately $400,000. If Edison could prevail on all of its positions, the Settlement Agreement and the Replacement PPA would, accordingly result in a loss to ratepayers of from $2.7 million to $15.2 million, depending on what would have transpired in the future over the course of the PPAs.

By contrast, Daggett's position is that the least Edison could hope to be liable if the PPAs and related agreements were litigated is $23.3 million. If Daggett could prevail on all of its positions, the Settlement Agreement and the Replacement PPA would, accordingly, result in a gain to Edison of between $7.7 million and $20.2 million, again depending on how the PPAs would have played out over time.

The proposed settlement would avoid litigation, regularize the property regime at the project site, set aside differences on how the PPAs would have turned out, and adjust the capacity payments in the Replacement PPA to result in payment of an additional $9.3 million to Daggett, based on assumptions that Edison and Daggett agree upon.

Prior Treatment of a Similar Settlement Agreement

We approved a similar settlement and power purchase restructuring agreement in 1994. (In re Southern California Edison Company (1994) (D.94-05-058) (hereafter U.S. Borax).) Like the present application, U.S. Borax involved differences between Edison and a QF concerning interpretation of a negotiated arrangement entered into prior to adoption of the SO2 regime. Like this application, the parties entered into a settlement agreement subject to Commission approval, including that the Commission find the successor SO2-form agreement to be reasonable and prudent so that payments made by Edison would be recoverable in full by Edison in rates, subject to review of administration.

The two applications are also similar in that they departed from the usual SO2 arrangements in favor of the utility with respect to certain payment arrangements. In U.S. Borax, we reviewed the settlement in light of the standards we set in an earlier case (In re Pacific Gas and Electric Company (1988) 30 CPUC2d 189) and found the settlement to be fundamentally fair, adequate, and reasonable in light of the whole record, consistent with law, and in the public interest.

In addition, we found in U.S. Borax that the settlement was the result of a lengthy negotiation process, conducted at arm's length, each party was in a good position to gauge the strengths and weaknesses of its respective case, litigation would impose substantial time and expense, and the amount of the settlement was in the range of probable outcomes.

Application of U.S. Borax to the Proposed Settlement Agreement

The history of the PPAs has not been harmonious. Beginning 13 years ago, shortly after the Original Agreement, the arrangements between the parties have been negotiated, amended, restated, and supplemented frequently. The current round of talks between the parties began in February 1993 with the initial discussions concerning the conditions leading to the FERC waiver discussed above and continued until about April 20, 1995.

Edison and Daggett, including Daggett's affiliates[20], are fully independent of one another. Nothing in the record suggests that they have negotiated the Replacement PPA and related transactions at anything less than arm's length.

Edison and Daggett have fully explored their respective positions and Edison has sufficient information to be able to

[20]Pursuant to the assigned administrative law judge's ruling, Daggett moved to become a party and filed an exhibit, under seal, that disclosed the ownership structure of the various entities involved on its side. That exhibit was made the subject of Daggett's motion for protective order, which was granted by the law and motion administrative law judge on date February 22, 1996.

assess the strengths and weaknesses of its position. We assume that Daggett is also able to assess its position, but we are not concerned with whether the proposed arrangements are fair to it. Presumably, if Daggett had any doubts on that score, it would not have settled. We are concerned solely with whether Edison, as the agent for ratepayers, is acting in an informed manner.

The history and issues in this dispute are complex and the amounts involved are sufficiently large to give reasonable assurance that the time and expense involved in litigation would be substantial.

Daggett's claims are colorable. Because the PPAs derived from the Original Agreement, which was not a standard offer form of contract that we prescribed, we will not analyze those claims further. Many factual matters remain at issue between the parties. It is sufficient for us to conclude, as we do, that the extent of material issues of fact indicated would likely provide Daggett with the opportunity to bring its claims to trial. At trial, its success or failure would depend on proof about which we are unwilling to speculate.

Likewise, Edison's estimates concerning the range of possible future outcomes under the PPAs are not implausible. Accordingly, the amount of the proposed settlement is within the range of probable joint outcomes of litigation concerning the PPAs and future conditions that would govern flow of funds between Edison and Daggett if Edison prevailed on its positions. Of course, virtually all such settlements fall within the range of probable outcomes, otherwise parties would not settle except when necessary to avoid litigation costs that are vastly out of proportion to the amounts at issue. No touchstone enables us to distinguish a principled settlement from merely splitting the difference. We look, rather, for objective indicators that the utility has conducted itself as agent for ratepayers as we would expect the utility to conduct itself on behalf of its

shareholders. Those are the same indicators discussed in U.S. Borax and which are augmented by others as circumstances warrant.

Required Condition

We will approve the Replacement PPA subject to the condition that Edison provide an opinion of counsel to the Executive Director, satisfactory in form, to the effect that the execution and delivery of the Replacement PPA by Daggett does not require the consent of Daggett's parent, if any, any subsidiary, partner or joint venturer, partnership in which Daggett has an interest, limited partnership in which Daggett has an interest, limited partners of such limited partnerships, affiliates, related entities, lienholders, security holders, or any other individual or entity under the terms of any contract, agreement, note, debenture, bond, instrument, security, or other arrangement by which Daggett is bound except such consents as have been obtained as of the date on which the Replacement PPA is to become effective.

The foregoing condition is necessary to assure that none of Daggett's predecessors-in-interest with respect to the Replacement PPA, including specifically LSP and LSP II, will be able to assert any claim against Edison with respect to the PPAs following the effectiveness of the Replacement PPA.

Analysis of Transfers of Property

The Amended Ground Lease is an interim measure the substance of which is overtaken by the Sale Agreement and the Water Use Agreement. Nevertheless, by its terms, it is subject to PU Code Section 851. However, if the Sale Agreement and the Water Use Agreement are in the public interest, there appears no reason why the lesser agreement would not be, as well. We note that the Sale Agreement provides for documentation of the surrender of the Amended Ground Lease through escrow.

The property that Edison seeks to transfer to Daggett (333 acres, some easements, and some water rights) is in rate base and therefore presumptively necessary or useful to the discharge of Edison's duties as a utility. Additionally, the facts show that such property is presently employed in the performance of the PPAs, pursuant to which Edison is obligated to purchase electricity. Accordingly, the property is also factually useful or necessary.

The property will undergo no change as a result of the Sale Agreement, the terms of which restrict the use of the property to the operation of the projects necessary for the Replacement PPA. In the Water Use Agreement, Edison has reserved from its allotment the amount of water that it actually uses at its Cool Water Generating Station. Additionally, pursuant to the Option Agreement, Edison may reacquire the property in the future at its appraised value. In these circumstances, it is not adverse to the public interest to permit the transfer of the rights covered by the Temporary Use Permit, the Amended Ground Lease, the Sale Agreement, and the Water Use Agreement.

Findings of Fact

1. Edison is an electric utility subject to the jurisdiction of the Commission.

2. Daggett is the general partner of two limited partnerships that each sell electricity to Edison under a non-standard form of power purchase agreement.

3. Edison and Daggett dispute the basis for payments under PPAs, the continuing effect of a FERC waiver, indemnification responsibilities for environmental remediation, payments for past use under expired temporary use permits, and whether certain claims are time barred.

4. The disputes between Edison and Daggett concerning the basis for payment include differing interpretations concerning

the proper heat rate values, incremental heat rate, treatment of combustion turbine and combined cycle units, the proper oil-to-gas conversion factor, the use of operation and maintenance and line loss factors, and the use of proxies for oil and gas costs.

5. If Daggett were to litigate its claims and prevail on each, Edison could be required to pay Daggett or third parties an additional $23.3 million over the amount that Edison believes it ought pay.

6. Edison and Daggett (or its predecessor-in-interest) have discussed changes to the PPAs since 1987.

7. Edison and Daggett have outstanding disputes concerning back rent for Daggett's occupation of certain Edison property.

8. Edison and Daggett negotiated over the PPAs and related issues from February 1993 until April 1995. Edison and Daggett entered into the Settlement Agreement, subject to Commission approval, to settle their differences.

9. The Replacement PPA is based on the SO2 form, which we have previously found suitable for certain contracts between utilities and QFs.

10. The Replacement PPA settles the differences between the parties related to payment by increasing the capacity payments that would otherwise be made under the usual SO2 arrangement and decreasing the energy payments.

11. Daggett agrees through the Remediation Agreements to determine the extent of and assume responsibility for existing contamination related to operation of the SEGS I and SEGS II projects.

12. Through the Sale Agreement, Edison agrees to convey to Daggett the property required for the operation of the SEGS I and SEGS II projects, subject to substantial restrictions on the use of the property. Through the Option Agreement, Edison will have

the right to acquire the property at its fair market value at the termination of the Replacement PPA, and on other events.

13. Through the Water Agreement, Edison agrees to provide certain water rights to Daggett from adjoining property to the extent that water is available after Edison's requirements are met.

14. Payments under the Replacement PPA compared to the PPAs will be from $3.1 million to $15.6 million greater, depending on assumptions regarding future conditions.

15. When combined with the range of amounts at issue between Edison and Daggett, such payments result in a range of outcomes of from a $15.2 million cost to ratepayers to a $20.2 million benefit.

16. The proposed settlement would avoid litigation, regularize the property regime at the project site, set aside differences on how the PPAs would have turned out, and adjust the capacity payments in the Replacement PPA to result in payment of an additional $9.3 million to Daggett, based on assumptions that Edison and Daggett agree upon.

17. We approved a similar settlement and power purchase restructuring agreement in 1994.

18. Edison and Daggett, including Daggett's affiliates, are fully independent of one another. Nothing in the record suggests that they have negotiated the Replacement PPA and related transactions at anything less than arm's length.

19. Edison and Daggett have fully explored their respective positions and Edison has sufficient information to be able to assess the strengths and weaknesses of its position.

20. The history and issues in the dispute between Edison and Daggett are complex and the amounts involved are sufficiently

large to give reasonable assurance that the time and expense involved in litigation would be substantial.

21. Daggett's claims are colorable.

22. The amount of the proposed settlement is within the range of probable joint outcomes of litigation concerning the PPAs and future conditions that would govern flow of funds between Edison and Daggett if Edison prevailed on its positions.

23. The Amended Ground Lease is an interim measure the substance of which is overtaken by the Sale Agreement and the Water Use Agreement.

24. The property that Edison seeks to transfer to Daggett is necessary or useful to the discharge of Edison's duties as a utility.

25. The property will undergo no change as a result of the Sale Agreement, the terms of which restrict the use of the property to the operation of the projects necessary for the Replacement PPA. In the Water Use Agreement, Edison has reserved from its allotment the amount of water that it actually uses at its Cool Water Generating Station. Additionally, pursuant to the Option Agreement, Edison may reacquire the property in the future at its appraised value.

26. No protests were filed.

Conclusions of Law

1. No hearing is necessary.

2. The Commission has jurisdiction to consider this application under PU Code Sections 851 and 2821(a).

3. The Settlement Agreement is reasonable in light of the whole record, consistent with law, and in the public interest.

4. We should approve the Settlement Agreement and the Replacement PPA, subject to the condition that Edison provide an

opinion of counsel to the Executive Director, satisfactory in form, to the effect that the execution and delivery of the Replacement PPA by Daggett does not require the consent of Daggett's parent, if any, any subsidiary, partner or joint venturer, partnership in which Daggett has an interest, limited partnership in which Daggett has an interest, limited partners of such limited partnerships, affiliates, related entities, lienholders, security holders, or any other individual or entity under the terms of any contract, agreement, note, debenture, bond, instrument, security, or other arrangement by which Daggett is bound except such consents as have been obtained as of the date on which the Replacement PPA is to become effective. The foregoing condition is necessary to assure that none of Daggett's predecessors-in-interest with respect to the Replacement PPA, including specifically LSP and LSP II, will be able to assert any claim against Edison with respect to the PPAs following the effectiveness of the Replacement PPA.

5. It is not adverse to the public interest to permit the transfer of the rights covered by the Temporary Use Permit, the Amended Ground Lease, the Sale Agreement, and the Water Use Agreement, and we should permit such transfer.

O R D E R

IT IS ORDERED that:

1. The Settlement Agreement dated as of March 17, 1995 by and between Southern California Edison Company (Edison) and Daggett Leasing Corporation (Daggett) (the Settlement Agreement) is approved as reasonable.

2. The Combined, Amended, and Restated Power Purchase Agreement by and between Edison and Daggett in the form attached to the application (A.) of Edison (the Replacement PPA) is approved as reasonable, subject to the condition that Edison

provide an opinion of counsel to the Executive Director, satisfactory in form, to the effect that the execution and delivery of the Replacement PPA by Daggett does not require the consent of Daggett's parent, if any, any subsidiary, partner or joint venturer, partnership in which Daggett has an interest, limited partnership in which Daggett has an interest, limited partners of such limited partnerships, affiliates, related entities, lienholders, security holders, or any other individual or entity under the terms of any contract, agreement, note, debenture, bond, instrument, security, or other arrangement by which Daggett is bound except such consents as have been obtained as of the date on which the Replacement PPA is to become effective.

3. Subject to Edison's prudent administration, it may recover payments to be made pursuant to the Settlement Agreement and the Replacement PPA through its energy cost adjustment clause or such other mechanism as may be authorized by further order by this Commission from time to time.

4. Subject to the terms and conditions of the Settlement Agreement, Edison is authorized to transfer the rights in property described in the Water Use Agreement between Edison and Daggett dated as of March 17, 1995 and Amendment No. 2 to Amended Ground Lease and Consent dated as of March 17, 1995 by and among Edison, Daggett, Luz Solar Partners, a California limited partnership, Luz Solar Partners II, a California limited partnership, Solar Project Management, Inc., a California corporation, CP National Corporation, a California corporation, CPN Leaseco, a California corporation, UCC-1985 Luz Solar II, a California limited partnership, and Solar Project Partners II, Ltd., a California limited partnership.

5. The authority granted hereby expires if not exercised within one year of the date of this order.

6. A.95-10-020 is closed.

This order is effective today.

Dated July 17, 1996, at Sacramento, California.

P. GREGORY CONLON
President
DANIEL Wm. FESSLER
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners