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Decision 97-02-013 February 5, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for Order Approving Termination Agreement for Termination of ISO4 Power Purchase Edison Company and Imperial Resource Recovery Associates, L.P.	Application 96-07-011 (Filed July 3, 1996)

O P I N I O N

1. Summary

Southern California Edison Company (Edison) seeks approval of a proposed buyout and termination of a 1985 power purchase agreement between Edison and Imperial Resource Recovery Associates, L.P. (Imperial).[1] Edison asserts that the buyout will provide customer benefits of $23.7 million for the remaining term of the contract. The application is granted.

2. Background

Imperial is a qualifying facility (QF).[2] It operates a 15-megawatt generating facility located near Imperial, California. Originally, the generating facility was intended to burn wood and agricultural waste, but the waste products caused slagging and operational problems. In response to the problems, Imperial began

1 Imperial is a California limited partnership. The general partners are Western Power Group Unit II, Inc., a subsidiary of Western Power Group, and HCE-Imperial Valley, Inc., a subsidiary of CMS Generation Company. Limited partners are the John Hancock Mutual Life Insurance Company and Western Power Group Unit I.

2 A QF is a small power producer or cogenerator that meets federal guidelines and thereby qualifies to supply generating capacity and electric energy to electric utilities. Utilities are required to purchase this power at prices approved by state regulatory agencies.

a modification program and, in mid-1993, restricted its fuel source to wood waste. Since the modifications, Edison states that the generating facility has operated smoothly and at consistently high capacity factors.

Edison and Imperial in April 1985 executed an Interim Standard Offer 4 power purchase contract, the standard at that time for long-term energy contracts between electric utilities and QFs. The term of the contract is 30 years. Energy payments for the first 10 years of the contract are based upon the Commission-approved forecast of Edison's avoided energy costs. Payments for the remainder of the contract term, extending from the year 2000 to 2020, are to be calculated at a rate equal to Edison's posted short-run avoided cost of energy.

In the fall of 1994, Imperial began participating in Edison's negotiated curtailment program. Under this program, Edison pays QFs to curtail their generation during periods when Edison's on-line generation resources exceed demand on the Edison system. QFs thus avoid production costs while still earning some revenue, and Edison avoids paying above-market rates for unneeded power. Under the program, Imperial curtailed operations for most of the months of April, May, and October 1995.

Edison states that it considered Imperial to be an attractive candidate both for curtailment and a contract buyout because Imperial's variable costs were believed to be significantly higher than Edison's replacement cost for energy. Thus, in late 1994, Edison proposed a buyout of the Imperial contract. On March 6, 1996, the parties executed the termination agreement that is now before the Commission for approval.

The termination agreement includes a suspension of required power purchases from Imperial, along with proposed monthly termination payments by Edison. According to Edison, savings to customers over the term of the contract will be at least \$9.6 million, and are more likely to reach \$23.7 million. If the

Commission does not approve the termination agreement, Edison asks for a determination that its proposed interim monthly payments are reasonable and may be recovered in rate proceedings. Edison states that the interim payments will represent a significant savings to ratepayers over the higher contract prices that otherwise would have been paid. (Application, p. 17.)

Edison filed this application on July 3, 1996. Notice of the application appeared in the Daily Calendar on July 19, 1996. The Office of Ratepayer Advocates (ORA), formerly the Division of Ratepayer Advocates, recommends approval of the application, although it initially expressed concerns that are discussed below. No protests to the application have been received. Along with the termination agreement itself, Edison also has filed the testimony of its employees who negotiated the buyout and who evaluated ratepayer benefits and the viability of the Imperial generating facility. (Exhibits SCE-2, SCE-4, and SCE-5.)

Edison moved to have the termination agreement and much of the supporting analyses received under seal. Edison argued that if other QFs examined the details of the termination agreement and the financial analysis, Edison would be at a disadvantage in negotiating future buyouts. The motion to seal was unopposed. By Administrative Law Judge's Ruling dated August 1, 1996, redacted portions of the Edison application and exhibits were placed under seal for one year, subject to renewal. Accordingly, we will be circumspect in our discussion of the termination agreement and its analysis.

3. Project Viability, Ratepayer Benefits

In past applications similar to this one, the Commission has required a persuasive showing that a buyout will benefit ratepayers more than keeping the contract in place, and that the QF generating facility is a viable one that would not be likely to shut down prior to completing the contract.[3]

Edison states that, since Imperial's conversion to wood-waste fuel in mid-1993, the performance of the generating facility has been excellent. Edison states that it concluded that there was no technical impediment to the facility's successful long-term operation. To confirm this, Edison retained a technical consultant experienced in biomass-fired power production. The information presented in the consultant's report is set forth in prepared testimony submitted with the application. (Exhibit SCE-2.)

In summary, the consultant's opinion is that the Imperial generating facility is technically viable and is capable of operating at a consistent capacity level of more than 91%. The conversion by 1993 to burning wood only, along with other facility improvements, resulted in capacity factors in the 90% range. During 1994 and 1995, the capacity factor had improved during the peak summer months to an average of nearly 100%.

Edison's consultant also concludes that the facility is economically capable of operating profitably through the balance of the first contract period in the year 2000. The consultant states that during the second contract period, beginning in the year 2000, Imperial will be able to operate economically during the summer months only, enabling Imperial to earn 84% of its annual capacity payment. Edison and its consultant project that Imperial would no longer be able to operate profitably after the summer of 2005, and that it is likely that the facility would shut down at that time.

3 See San Diego Gas & Electric Company, Decision (D.) 94-12-038 (December 21, 1994); Southern California Edison Company, D.95-10-041 (October 18, 1995); Southern California Edison Company, D.95-11-058, 165 PUR4th 441 (1995). See, generally, Power Purchase Contracts, D.88-10-032, 29 CPUC2d 415 (1988); Opinion on Guidelines for Year 11-Related Restructuring, D.94-05-018, 54 CPUC2d 383 (1994).

Edison also performed an economic analysis of the termination agreement, setting forth its conclusions in Exhibit SCE-4. Generally, Edison estimates ratepayer benefits under an "expected case" scenario of $23.7 million (net present value as of January 1, 1996 at a 10% discount rate). These savings result from the replacement of Imperial's high energy and capacity prices under the standard offer contract with lower-priced energy and capacity based on Edison's projected replacement costs, net of the termination payments. The estimate also assumes that the plant would have shut down in October 2005. The "worst case" scenario, projecting savings of $9.6 million, assumes an earlier plant shutdown.

4. Staff Evaluation

The Commission's advocacy staff responded to Edison's application on August 19, 1996. Staff recommended approval of the buyout agreement, but raised two issues of concern. First, staff noted that Edison intends to pursue a Commission proposal that, as an incentive, a utility be permitted to retain 10% of the savings when it restructures and reduces the cost of a QF contract. (See Decision (D.) 95-12-063, as modified by D.96-01-009, p. 132.) Staff was concerned that a forecasted 10% in a transaction like this one could cut into the ratepayer savings actually realized.

The second concern raised by staff is the Commission's policy on promoting renewable energy. In D.95-12-063, the Commission advocated promoting renewable energy through a minimum renewables portfolio standard implemented through tradable credits. While that standard has not yet been developed, staff was concerned that the treatment of renewables could raise the cost of power from replacement resource contracts above otherwise prevailing prices and could cut into projected savings of a buyout agreement.

Edison, in a response dated August 28, 1996, stated that it agreed with staff that the 10% incentive issue should be dealt with in another proceeding, and it should not be the subject of prospective approval in this application. Edison states that it simply wants the right to assert that this contract would be eligible for such an incentive if that program develops. Staff has no objection to proceeding in this manner.

The administrative law judge, by ruling, asked the parties to comment on whether California's recently enacted electric industry restructuring bill (Assembly Bill 1890 (Brulte)) affected staff's concern about the direction of the renewable energy standards. ORA responded:

> "AB 1890 has several provisions that address renewable energy. The most relevant such provision, now P.U. Code Section 381(c)(3), establishes a nonbypassable surcharge to support existing, new, and emerging renewable resource technologies. It is ORA's understanding that the legislature specifically chose to adopt a surcharge approach instead of a portfolio standard (minimum purchase requirement) approach to supporting renewables. In P.U. Code Section 383(b), the legislature also directed the California Energy Commission to prepare a report by March 31, 1997 regarding market-based mechanisms to allocate the funds." (Response of ORA, November 8, 1996, p. 4.)

Based on these developments, ORA concludes that it is unlikely that the mechanisms finally adopted will rely on minimum purchase requirements and, therefore, ratepayer renewable energy premium costs are not likely to increase to a point that would make the Edison/Imperial Resources buyout agreement uneconomic. ORA states that AB 1890 "increases [ORA's] expectation that ratepayer benefits will stem from this Agreement." ORA recommends that the buyout agreement be approved.

5. Discussion

The Commission scrutinizes the reasonableness of buyouts on a case-by-case basis. We realize that the fixed prices paid to a QF for the first 10 years of an Interim Standard Offer 4 contract generally have been higher than the short-run avoided cost prices that will be paid after the initial 10 years. We look closely, therefore, at whether ratepayer benefits of a buyout exceed the lower energy prices that can be expected to be paid over the life of the power purchase agreement. We look closely, as well, at whether the QF project is likely to continue in operation, since it would make no sense to make buyout payments to an energy supplier that was not likely to stay in business. Edison has adequately demonstrated that the Imperial facilities meet the Commission's viability criteria.

Findings of Fact

1. The Imperial power purchase agreement is technically and economically viable.

2. The termination agreement will yield net savings in the range of $23.7 million, and, therefore, will result in substantial ratepayer benefits.

3. No protests have been received, and no hearing is necessary.

4. In similar proceedings, the Commission has conditioned permanent recovery of expenses incurred under the approved agreements upon reasonable contract administration by the utility.

Conclusions of Law

1. The termination agreement should be approved as reasonable.

2. Edison's request for recovery of expenses incurred under the termination agreement should be conditioned on Edison's reasonable performance of its obligations and exercise of its rights under the terms of the agreement.

3. The application should be granted as provided in the following order.

4. In order that benefits of the termination agreement may be realized promptly, this order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The application of Southern California Edison Company (Edison) for approval of the contract termination agreement between Edison and Imperial Resource Recovery Associates, L.P. (the Termination Agreement), as set forth in Exhibit SCE-3 of the application, is granted, and the Termination Agreement is approved.

2. The Termination Agreement is found to be reasonable, and Edison's actions in entering into the agreement were prudent.

3. Edison is authorized to recover in rates all payments under the Termination Agreement through its Energy Cost Adjustment Clause, or any other mechanism authorized by the Commission, to the same extent as any other cost associated with a qualifying facility is recoverable, subject only to Edison's prudent administration of the Termination Agreement.

4. This proceeding is closed.

This order is effective today.

Dated February 5, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners