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Decision 97-02-050 February 19, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U-338-E) for Order Approving Agreement for Buyout of Power Purchase Agreement Between Southern California Edison Company and Dixie Valley Power Partnership.	Application 95-09-017 (Filed September 1, 1995)

OPINION

This decision grants the application of Southern California Edison Company (Edison) for approval of a negotiated buyout of a long-term power purchase contract (buyout agreement). In approving the buyout we do not need to either approve or reject a modified long-term power purchase contract (modified contract) with Dixie Valley Power Partnership (Dixie Valley) that Edison entered into as an alternative to the buyout. However, this decision includes several observations about the terms of the modified contract.

I. The Dixie Valley Project

Dixie Valley is an unfinished 25 megawatt (MW) geothermal project located in Nevada. In Decision (D.) 90-08-046, the Commission approved a nonstandard contract for the project (referred to hereafter as "the original contract") when the project was owned by Caithness and Yankee Caithness Joint Venture, L.P (jointly, Caithness). ESI Energy, Inc. (ESI), a subsidiary of Florida Power and Light Group (FP&L) purchased a managing interest in the project in 1994.

Under the terms of the original contract with Edison, the project would provide 16.5 MW of firm capacity for 30 years beginning in September 1995. Capacity payments are fixed for the life of the contract at $198 per kilowatt year (about 2.3 cents per kilowatthour). Energy prices are fixed during the first 10 years of operation and increase from 9.7 cents per kilowatthour in the first year to 15.4 cents per kwh in the tenth year. During years 11 through 15, energy payments are based on Edison's avoided cost plus a fixed amount. Energy prices during subsequent years are equal to Edison's published avoided cost.

Edison estimates the cost of this power under the original contract to be about three times higher than the value of the power. Dixie Valley suspended construction of the project in July 1994 to renegotiate its contract with Edison and has not since resumed construction.

II. Procedural Background

Edison filed this application on September 1, 1995. Edison requests ex parte approval of the application. On October 25, 1995, the Commission's Division of Ratepayer Advocates (DRA), subsequently renamed the Office of Ratepayer Advocates (ORA), filed a pleading stating its support for the application.

On October 23, 1995, the law and motion judge granted the motions of Edison and Dixie Valley to treat certain information in the application as confidential by filing certain portions of the application under seal for a period of 12 months.

On December 5, 1995, the assigned administrative law judge (ALJ) issued a ruling requiring Edison to serve a copy of its application, or a notice of availability pursuant to Rule 5(c), on all parties of record in I.85-11-008 and extended the protest period for the application to 30 days following service of the application to parties in I.85-11-008. The ruling required the service on the basis that Section 1708 requires the Commission to provide notice and opportunity to be heard when it modifies a previous order. Application (A.) 95-09-017 seeks modification of D.90-08-046, which approved the nonstandard contract between Edison and Dixie Valley. We affirm the ALJ's ruling.

In response to the December 5 ruling, Edison served notice of its application on all parties in I.85-11-008 on December 14, 1995.

On April 3, 1996, the assigned ALJ issued a ruling directing Edison to file, by May 3, 1996, responses to a number of questions relevant to the application. Subsequently, Edison sought two extensions of time to respond to the questions, which the ALJ granted. Edison and Dixie Valley filed their separate responses on June 14, 1996.

In response to requests from the active parties in this proceeding the Assigned Commissioner directed the ALJ to allow comments to be filed on the proposed decision (PD). On November 7th an ALJ Ruling was issued giving parties until December 6, 1996 to file comments. Comments were received from Dixie Valley, Edison, and ORA. An Assigned Commissioner Ruling (ACR), issued January 24, 1997, sought supplemental comment on Dixie valley's compliance with its requirements under Section 11 of its contract. Dixie Valley, Edison, and ORA filed comments in response to the ACR on January 31, 1997.

III. Confidentiality

Upon the motion of Edison and Dixie Valley and lacking any protest, the Commission permitted Edison to file almost all information relevant to reviewing this application under seal. The public has received no notice of the costs of this buyout agreement that would be included in rates.

The assigned ALJ issued a ruling on January 30, 1996 soliciting comments of the parties regarding whether the buyout agreement, the modified contract and Edison's analysis of customer benefits should be public. On February 14, 1996, Edison filed a response arguing that these matters should remain confidential on the basis that public disclosure would compromise its bargaining position in future negotiations with other qualifying facilities (QFs). Dixie Valley emphasizes that certain information in the application is commercially sensitive. San Diego Gas & Electric

Company, DRA, and Independent Energy Producers filed responses offering comments similar to Edison's.

The Commission has permitted confidentiality in these cases on the basis that disclosure of buyout contract terms will disadvantage Edison, on behalf of ratepayers, in future negotiations with QFs. We can imagine a circumstance where a QF would refuse a buyout offer because it believed another QF got a better deal. The result would be higher costs to ratepayers. We balance this concern with the fact that Edison has no explicit incentive to negotiate the best deal on behalf of ratepayers. Under the regulatory mechanisms that apply in this case, Edison will recover every penny of the costs of a buyout agreement if it is found reasonable.

Recognizing that such a regulatory arrangement does not provide adequate incentives, the Commission in Decision (D.) 95-12-063 established an incentive for the utilities to negotiate hard with QFs on behalf of ratepayers. In that proceeding, we adopted an incentive for utilities to maximize ratepayer benefits resulting from QF contract negotiations by allowing the utilities to keep 10% of those benefits. We have stated our intent to allocate some of the benefits of renegotiation to the utilities in hopes of providing an incentive for them to drive a hard bargain on behalf of ratepayers. Until such an incentive is in place, however, we must more carefully assess the reasonableness of buyout agreements to protect ratepayers from agreements that do not adequately protect their interests. As part of that review, we will disclose any information which we believe is necessary in order to fulfill our obligation to be accountable to the public.

In this case, Edison and other parties are correct that disclosing the terms of the buyout agreement and the modified contract may influence future negotiations with other QFs. That is precisely why we believe some of the information should be made public. In the case here, the QF is better off under the terms of the buyout and the modified contract than it would have been under the original contract. Although ratepayers are better off than they would be if they remained liable for payments under the original contract, we still need to review the contract to ensure that it is reasonable. Thus, confidentiality in this case will not benefit ratepayers with respect to future contract negotiations. To the contrary, we disclose some terms of the buyout agreement and the modified contract partly for the purpose of signalling Edison and QFs in future negotiations as to liabilities in buyout agreements that should not be borne by ratepayers.

Further, the Commission has always required public disclosure of nonstandard power purchase contracts between QFs and utilities. The modified contract proposed here is just such an instrument. Dixie Valley argues that disclosure of the milestone dates in the modified contract "could be used by a contractor to induce additional payments from Dixie Valley by delaying until a particular milestone deadline was imminent." Milestone dates, however, are included in every standard and nonstandard QF contract and all are subject to public disclosure. In response to the ALJ's inquiry, Dixie Valley argued in effect that all nonstandard contracts should be considered confidential. It did not, however, distinguish the modified contract submitted here from any other to support a reversal of our long-standing policy to require disclosure. We are not aware of any circumstance where a QF's contractor delayed construction for the purpose of unlawfully extorting concessions from a QF that was subject to a contract milestone. Presumably, such an act would be a breach of the contract between the contractor and the QF and would be a matter for the courts. We will not change Commission policy in this instance to provide Dixie Valley protections that are not available to other QFs and where it has remedies in other forums. Moreover, this is not the appropriate forum for determining the reasonableness of the Commission's policy more generally.

This decision discloses certain elements of the buyout agreement and modified contract in order to provide guidance for future negotiations. The following discusses only those contract elements which we believe would provide guidance to the parties or, in some cases, those which were disclosed by Edison in notices of ex parte communications.

IV. The Application

On June 8, 1995, Edison and Dixie Valley executed a buyout agreement that would terminate the original nonstandard contract between Edison and Dixie Valley. The application seeks approval of that buyout agreement. Under the terms of the buyout agreement, Dixie Valley would receive 84 monthly payments in lieu of payments for power over a 30-year period. The application estimates net ratepayer benefits, depending on various assumptions about future market conditions.

If the Commission does not approve the buyout agreement, the application seeks approval of a modified contract[1] which (1) moves the final construction date out 41 months from the date the Commission rejects the buyout and (2) increases QF payments to compensate Dixie Valley for inflation occurring over the intervening period, about five years. The original contract is suspended pending our regulatory review of this application.

V. Guidelines for QF Contract Buyouts

In Rulemaking to Establish Guidelines for the Administration of Power Purchase Contracts Between Electric Utilities and Qualifying Facilities, 29 CPUC2d 415 (1988) (Guidelines), D.88-10-032 established guidelines for buyouts of QF contracts. There, we stated our intent to consider the reasonableness of buyout contracts by applying stringent test of project viability. We did so to preclude the possibility that the buyout would be used to "breath life into a moribund" project. In that context, we found that ratepayers should not pay "money for something they would have received for free, if the project were in fact not viable." We also stated that a "negotiated deferral (paid

1 The "modified contract" referred to herein is the original power purchase contract with the modifications set forth in "Exhibit C to Buyout Agreement, Amended and Restated Tolling Agreement."

or nonpaid) or buyout, compared to any other type of contract modification, puts the ratepayers at the greatest risk that the agreement breathes life into a moribund QF. Accordingly, our threshold test of viability for these types of modifications will be stringent" (29 CPUC2d 433).

Further, we have found in that decision that QF contract buy-outs might be reasonable in certain cases but that the "implementation problems associated with...buyouts dictate a cautious approach." Contract modifications which provide concessions to QFs are reasonable "only if commensurate concessions are made to benefit ratepayers" (29 CPUC2d 433).

We address the Dixie Valley buyout with these principles in mind.

VI. Issues

A. Project Viability

Rule IV.2 in D.88-10-032 provides that modifications to a power purchase contract are not reasonable if the project is not viable. We consider the issue of project viability first because it will affect our assessment of the reasonableness of the buyout agreement and contract modifications proposed here.

Overall, the financial analyses and geothermal resource reports presented by the parties indicate certain risks Dixie Valley would have to assume if it were to go forward to develop the project. If the Dixie Valley project is not viable, the original high-priced contract would never take effect and ratepayers would bear no cost for the project.

The Geothermal Resource. Edison states the Dixie Valley project is a viable geothermal resource. It presents two studies which address the likelihood that the geothermal resource is of commercial quality. One, a study performed by the Mesquite Group, Inc. (Mesquite) for Dixie Valley, concludes that the geothermal resource is "developable." Mesquite issued the report in November 1994, several months after Edison and ESI initiated buyout negotiations.

Because Mesquite had been hired by Dixie Valley and "played an integral role" in project development, Edison subsequently hired its own consultant, Cascadia Exploration Corporation (Cascadia), to evaluate the geothermal resource's commercial viability.

Cascadia's report, completed in January 1995, applies different terminology from that used by Mesquite, finding that the resource was "probable" but not "proven." We accept the reports' assessments that the project appears to be commercially viable.

Transmission Access. Edison has previously stated its concern that the project may not be able to obtain transmission service from Nevada to Southern California. Edison now states its view that the project may have transmission service from Oxbow Geothermal Corporation because Dixie Valley has "obtained a ruling from the FERC that such arrangement would not be inconsistent with the Project's QF status." The FERC order finds that the Dixie Valley project is a QF (68 FERC P62,073, Docket QF93-148-000). It does not order Oxbow to provide transmission service or otherwise guarantee transmission service for the Dixie Valley project. Apparently, Dixie Valley would be able to secure an order from the FERC which would direct Oxbow to wheel Dixie Valley power pursuant to Section 211 of the Federal Power Act. Dixie Valley has not initiated such a request to FERC because it is seeking to negotiate a lease with Oxbow.

We accept the parties' assertion that Dixie Valley would be able to acquire transmission access on a timely basis.

Financial Viability. The application presents analysis to support Edison's view that the project is financially viable. Edison estimates that Dixie Valley is profitable depending on assumptions regarding discount rates and financing costs. Edison's analysis assumed annual transmission costs that are about half the amount negotiated between Dixie Valley and Oxbow in a letter of intent on Oxbow.[2] Edison's financial analysis assumes that Dixie Valley would incur development costs that are average for similar geothermal energy projects.

We find that Edison's analyses of the project's financial viability are reasonable.

On-Line Date. Edison presents a timeline and corresponding documents which satisfy the requirement that the project could have been on-line by the original contract milestone.

B. The Buyout Agreement

The buyout agreement appears to provide net ratepayer benefits. The buyout agreement would terminate the original contract for about $82 million, about $52 million in net present value.[3] Edison would make the payments monthly over a seven-year period. Edison would enter the payments into its ECAC account as they are made. The buyout agreement does not relieve Edison of any general obligations it may have with Dixie Valley under the requirements of PURPA. Therefore, nothing in the buyout precludes Dixie Valley from completing its geothermal project at some future date and operating it as a merchant plant, selling its power to Edison, or others, under applicable short-run avoided cost, direct access, or power exchange protocols as they may exist in the future.

Edison estimates the buyout could save ratepayers between $34 million and $66 million. Edison believes the buyout agreement

2 In response to the ALJ's inquiry, Edison provided a modified financial analysis that incorporated the transmission costs estimated in the letter of intent. Using those costs, Dixie Valley's after-tax profits would fall by about $4 million net present value.

3 The contract buyout cost was originally subject to a ruling of confidentiality. Edison subsequently waived confidentiality when it disclosed the cost in a Notice of Ex Parte Communication dated January 16, 1996.

will most likely save ratepayers $60 million over a 30-year period[4] depending on assumptions about future energy costs and project capacity factors. Edison's analysis assumes that it will need to purchase replacement power.

The buyout agreement presents ratepayers with net benefits and is based on reasonable assumptions about the project's viability and future market conditions.

C. The Modified Contract

The modified contract provides several concessions to Dixie Valley in the event the Commission declines to approve the buyout agreement. Since we are approving the buyout, the terms of this modified contract do not take effect. However, we have reviewed the terms of the modified contract and note that the modified contract would fail to adequately protect ratepayer interests. The modified contract would have provided numerous concessions to Dixie Valley but would have offered nothing to ratepayers in return. Additionally, the modified contract did not contain any "regulatory out" provision making the contract subject to Commission approval. Such contracts can put significant risk upon Edison, should the Commission decline to approve the contract, as well as potentially limiting the options available to the Commission in reviewing proposed buyouts.

The modified contract would extend the on-line date by 27 months from the date of a Commission order, in addition to the 14 months originally remaining in the contract when it was tolled and the period required for our regulatory review. This deferral is excessively generous and appears to be substantially longer than

4 These estimates were originally subject to a ruling of confidentiality. Edison subsequently waived confidentiality when it disclosed the estimates in a Notice of Ex Parte Communication dated January 16, 1996 and a Notice of Ex Parte Communication dated February 23, 1996.

any other contract deferral that the Commission has previously granted. It also is not consistent with, and appears overly generous, given the underlying contracts that Dixie Valley had entered into with its suppliers and Edison's claim that the project could achieve commercial viability within the 14 months remaining on its contract.

The Commission has developed very explicit policy regarding ratepayer liability for contract deferrals such as contained in the modified contract. Specifically, Rule III.7 of the Guidelines provides, "On-line deferrals and/or contract buyouts may be considered only if the ratepayers' interests will be served demonstrably better by such deferral." Rule III.8 provides, "The reasonableness of contract deferrals and buyouts will be determined by evaluating the need for generating capacity, the length of deferral, the costs avoided by deferring or buying out unneeded capacity, and the benefits (both monetary and non-monetary) granted projects acceding to deferral or buyout" (29 CPUC2d at 441).

No party to this proceeding has demonstrated, or even suggested, that the contract amendments for which Edison seeks approval improve ratepayers' circumstances.

Additionally, the the contract deferral created by the modified on-line date is unreasonable because it provides a concession to Dixie Valley for which ratepayers receive no offsetting benefits. Edison states, and the modified contract confirms, that the the 27-month extension is provided "to minimize the cost impact" of the tolling period to Dixie Valley. The extension protects Dixie Valley although it may ultimately increase the cost to ratepayers of the power purchase contract relative to other energy supplies. The extension is a concession to Dixie

Valley which, contrary to Commission policy, is not offset by contract modifications which benefit ratepayers.[5]

Similarly, the application proposes to increase power payments to Dixie Valley as part of the modified contract. The increased payments, according to Edison, "compensate Dixie Valley for the delay in cash flows due to the tolling period." The delay in cash flows, however, has not been shown to benefit ratepayers. To the contrary, ratepayers could be relatively worse off from the deferral if, as we expect, energy prices fall with the introduction of competition. Ratepayers receive no offsetting benefit for this concession, contrary to Commission policy requiring that modifications to elements of QF contracts must be offset by commensurate concessions to ratepayers (29 CPUC2d at 426).

Ratepayers are not indifferent to paying $28 million more to Dixie Valley to reflect inflation during the deferral period. Dixie Valley signed a contract which imposed on ratepayers and Dixie Valley certain risks, including the risks associated with future energy prices which in turn reflect the effects of inflation. The only possible benefit ratepayers might receive from the project's deferral, based on the record before us, is relief from the effects of inflation during the tolling period. The modified contract eliminates even that potential benefit to ratepayers. The risk associated with the tolling period, however, should not be assumed by ratepayers in this case. The original contract evolved from complicated disputes between Dixie Valley and Edison and was subject to an extensive reasonableness review by the Commission before it became effective. By tolling the contract, Dixie Valley and Edison agreed to change the on-line milestone date. In so doing, they changed one of the contract's most

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5 We do not here take issue with the provision which suspends contract terms for the purpose of our review of this application.

essential terms--and one upon which we relied in assessing the merits of the original contract--without Commission approval.[6]

Fortunately, in approving the buyout agreement, we are not faced with the consequences of the modified contract.

VII. Conclusion

We will approve the buyout agreement proposed here because it would provide net benefits to ratepayers compared to the original contract.

Findings of Fact

1. Dixie Valley is an unconstructed geothermal project located near Reno, Nevada which is subject to a nonstandard power purchase contract with Edison.

2. Edison estimates the original nonstandard contract between Dixie Valley and Edison would cost ratepayers about three times more than the value of the power purchased under the contract's terms.

3. Edison filed this application seeking approval of a buyout agreement that would terminate the nonstandard contract or, in the event the Commission declines to approve the buyout agreement, modifications to the original nonstandard contract.

4. The Commission's policy requires public disclosure of nonstandard power purchase contracts such as the modified contract for which the parties seek approval here.

5. No party has distinguished the modified nonstandard contract which is the subject of this application from other

6 D.90-08-046, which approved the contract, states that "the new milestones for interconnection and transmission are cited as substantial ratepayer benefits." (Mimeo. at 8.)

nonstandard QF contracts for purposes of maintaining confidentiality.

6. The buyout agreement would provide net ratepayer benefits in a range that depends upon assumptions about future market conditions.

7. Edison believes the Dixie Valley project is viable under the terms of the original nonstandard contract.

8. If the buyout agreement is not approved, Edison had entered into a modified contract with Dixie Valley that would extend the final construction date of the Dixie Valley project by 41 months from the date of a Commission order in this proceeding, increase payments to Dixie Valley to offset the effects of inflation on Dixie Valley's cash flows, and grant Dixie Valley a substantial extension of time to secure a completed agreement for transmission access.

9. At the time Edison and Dixie Valley agreed to toll the original nonstandard contract, Dixie Valley had 14 months to complete the project to meet the milestone of that contract.

Conclusion of Law

The Commission should grant Edison's request for approval of a buyout agreement with Dixie Valley which is the subject of this application.

ORDER

IT IS ORDERED that the request of Southern California Edison Company (Edison) for approval of a negotiated buyout of a long-term power purchase agreement with Dixie Valley Power Partnership (Dixie Valley) is granted, and is recoverable in rates to the extent permitted by law.

This order is effective today.

Dated February 19, 1997, at San Francisco, California.

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