

Decision 97-11-064 November 19, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U-338-E) for Order Approving a Settlement Agreement Between Edison and GEO East Mesa Electric Company, GEO East Mesa Limited Partnership, New East Mesa Limited, EMP Inc. and Credit Suisse.

Application 97-08-055
(Filed August 20, 1997)

ORIGINAL

OPINION

1. Summary

In this application, Southern California Edison Company (Edison) seeks approval of an April 1997 settlement agreement between Edison and the defendants in a breach-of-contract lawsuit brought by Edison in Los Angeles County Superior Court. The defendants are GEO East Mesa Electric Company (GEMEC), Geo East Mesa Limited Partnership (GEMLP), New East Mesa Limited (New East), EMP Inc. (EMP), and Credit Suisse. The settlement agreement (hereinafter sometimes referred to as the GEMEC Settlement) would result in a payment to Edison of \$2,632,650 plus interest, and dismissal of the lawsuit by Edison. **Granted.**

2. Background

This matter involves a qualifying facility (QF) project located in the Imperial Irrigation District (IID) service territory. The background of the lawsuit filed by Edison, and the ensuing settlement for which Edison seeks approval, are described in this section.

2.1 The Contract

In February 1984, Edison, as purchaser, and Magma Electric Company, as seller, signed a modified, 30-year, Interim Standard Offer 4 (ISO4) contract that provided for a 9 megawatt (MW) (6 MW firm) geothermal project. The contract provided that during the first 10 years, Edison would purchase energy at a fixed rate equal to the Forecast of

Annual Marginal Cost of Energy. For the remainder of the contract term, energy purchases would be made at a price equal to Edison's published, avoided cost of energy. The contract also provided for Edison to make fixed capacity payments over the 30-year term that were calculated with the assumption that the seller would provide Edison with 6 MW of capacity for the entire 30-year contract term. Any reduction in the amount of capacity provided entitled Edison to a refund of capacity overpayments.

Section 26 of the contract required the seller to reimburse Edison for transmission service costs provided to seller for delivery of electrical power from the project to Edison's distribution system via the IID transmission lines. Reimbursements were to be made within 30 days of seller's receipt of the notice of the amount due. Section 26 also required seller to fund a reserve account to assure reimbursement of the transmission service costs.

2.2 Defendants

In May 1988, Magma Electric Company, formerly a subsidiary of Magma Power Company, changed its corporate name to GEO East Mesa Electric Company (GEMEC). The name change occurred in conjunction with Magma Power's sale of the project to Geothermal Resources International Inc. GEMEC, a Nevada corporation authorized to do business in California, and owner of the project, is wholly owned by GEMLP, a California limited partnership. The partners of GEMLP are New East, a California limited partnership, and EMP, an Oregon corporation. Both New East and EMP hold general and limited partnership interests in GEMLP. New East's general partner is Geo East Mesa, Inc., a wholly-owned subsidiary of Geothermal Resources International Inc.

In December 1988, Mission Energy Company (now Edison Mission Energy; a wholly-owned subsidiary of the Mission Group, which in turn is a wholly-owned subsidiary of Edison International, Edison's parent) acquired a 50% interest in GEMLP through acquisition of EMP.

Credit Suisse is a bank organized and existing under the laws of Switzerland. It was assigned a security interest in GEMEC's assets to secure certain loans that had been made to two other, related geothermal projects.

2.3 Abandonment of the Project

The project commenced firm operations on February 8, 1984. The second contract period during which energy payments would be based upon Edison's published avoided cost of energy commenced on February 9, 1994. In March 1994, when the period for fixed-price energy payments under the contract ended, GEMEC ceased operating the project without notice to Edison. The project has not operated since then.

In June 1994, GEMEC advised Edison in writing that it was analyzing the costs of continuing plant operation. In August 1994, GEMEC advised Edison of its interest in canceling the contract, and it sought information about potential cancellation issues. In September 1994, Edison informed GEMEC that, based on a July 1, 1994 termination date, GEMEC would owe Edison \$2,534,973 in capacity overpayments plus unreimbursed IID transmission service charges.

As of April 18, 1995, the project remained non-operational, and GEMEC had not reimbursed Edison for capacity overpayments or IID transmission service charges. On that date, Edison notified GEMEC in writing that the project was deemed abandoned effective October 8, 1994 and was derated to zero. Edison also notified GEMEC that as a result of the abandonment, GEMEC owed Edison \$2,633,964 for capacity overpayments and accrued interest. GEMEC then acknowledged abandonment of the project, and it requested termination of the IID transmission service agreement.

Edison and GEMEC engaged in settlement discussions over the next several months. GEMEC contended that it was insolvent, and that payment of the amounts due to Edison would force it to seek bankruptcy protection. GEMEC presented what Edison regarded as credible evidence that it had other creditors, which supported the claim that the estate would not be large enough to pay all claims against it. The evidence presented by GEMEC included financial statements for GEMEC and GMLP

and letters from Credit Suisse.¹ GEMEC also informed Edison that Credit Suisse controlled GEMEC's cash reserves as collateral for loans made to certain entities related to GEMEC through common upstream ownership.

2.4 The Lawsuit

The settlement discussions described above did not lead to an agreement. On November 28, 1995 Edison filed a complaint in Los Angeles County Superior Court (Case No. BC 139810) against GEMEC, GEMLP, New East, and EMP for breach of contract. The complaint sought damages of \$2,534,973 plus interest for unearned capacity payments, and \$20,200 for unpaid transmission service charges.

After the lawsuit was filed, Edison and defendants stipulated to an extension of the time for an answer, and they continued to engage in settlement talks. In February 1996, GEMEC asserted that Edison owed it \$333,548 in lost energy and capacity payments, based primarily on a claim of improper denial by Edison of uncontrollable force claims.

In July 1996, Edison amended the complaint to add Credit Suisse as a defendant on the theory that the other defendants had fraudulently transferred to Credit Suisse the project's cash reserves as collateral for loans made by Credit Suisse to entities other than GEMEC.

Defendants answered the amended complaint in September 1996, denying the charging allegations and alleging various affirmative defenses. Settlement discussions were continued, and by approximately November 1996 the parties reached an

¹ The application originally referred to numerous documents regarding GEMEC's financial position, particularly documents backing up the claim that it would be forced to seek bankruptcy protection in the absence of settlement, which GEMEC provided to Edison before the lawsuit was filed. On October 30, 1997, Edison filed an errata to the application indicating that the referenced documents regarding the financial position of GMEC were not "numerous," and were provided to Edison after the filing of the lawsuit. It appears that, with reasonable care, Edison could have and should have more accurately drafted the application and supporting testimony and verified the same for accuracy, thereby avoiding the resulting confusion and efforts required by ORA to clarify the confusion. This in turn would have avoided delays in processing this application which jeopardized timely issuance of a decision.

agreement in principle to settle the lawsuit. The agreement was reduced to writing and executed by all parties effective April 15, 1997.

2.5 The GEMEC Settlement Agreement

The GEMEC Settlement and related escrow instructions, along with three Letter Agreements dated June 12, 1997, June 25, 1997, and July 18, 1997, respectively, include the following provisions:

1. Commission Approval

The GEMEC Settlement and related escrow instructions require Commission approval of the settlement by December 1, 1997. Edison may waive this condition in its sole discretion.

2. Tender of Request for Dismissal and Payment to Edison

On or about April 18, 1997, GEMEC deposited into an escrow account the sum of \$2,632,650. If the Commission approves the GEMEC Settlement by December 1, 1997, or if Edison elects to waive this condition, Edison will tender to the escrow agent an executed Request for Dismissal of the Lawsuit and the agent will release to Edison the original principal balance of \$2,632,650 plus interest from April 18, 1997.

3. Abandonment of the Project

If the Commission approves the GEMEC Settlement by December 1, 1997, or if Edison waives this condition precedent, Edison, GEMEC, GEMLP, New East, EMP, and Credit Suisse agree that the project is abandoned.

4. Amendments to Require Pre-Approval of the Settlement

The GEMEC Settlement and related escrow instructions originally contemplated that Edison would not seek Commission pre-approval of the settlement. However, it did provide that Edison would have until June 15, 1997 to obtain from the Office of Ratepayer Advocates (ORA) its written concurrence expressing the opinion that the GEMEC Settlement is reasonable and prudent and that Edison is not required to seek Commission pre-approval by the QF Affiliate Settlement Agreement adopted in Decision (D.) 93-03-021 (Affiliate Settlement). ORA did not provide the requested concurrence. ORA took the position that Edison's agreement to accept less than 100% of the full capacity overpayment due from GEMEC constituted a "contract modification" within the meaning of the Affiliate Settlement. Edison disagreed with ORA's position and continues to do so. Edison

nonetheless concluded that it would be prudent to seek Commission pre-approval. The July 18, 1997 Letter Agreement provides that Edison would seek and obtain Commission pre-approval of the GEMEC Settlement by December 1, 1997, and dismiss Credit Suisse from the lawsuit.

3. Procedural History

Edison filed this application on August 20, 1997, seeking expedited *ex parte* approval of the settlement by December 1, 1997. The matter was noticed on the Commission's Daily Calendar of August 28, 1997. ORA requested an extension of time to October 6, 1997 to file a protest or response. The request was made on the grounds that Edison was expected to provide a response to an ORA data request which could obviate the need for a protest, but the response was not expected until after the otherwise applicable September 29 due date. The extension was granted, and a second extension to October 14 was granted for similar reasons.

ORA filed its response on October 14, 1997. ORA urges strict scrutiny of the application because it involves a settlement with an affiliate. However, ORA takes no position on approval of the settlement. ORA states this is because of its concerns regarding allegedly inaccurate information contained in the application.² Pursuant to Rule 44 of the Rules of Practice and Procedure, ORA presented information which it believed would be useful to the Commission in acting on the application.

No other protests or responses to the application were received.

4. Discussion

4.1 Basis for Consideration

The GEMEC Settlement is before the Commission by virtue of the Affiliate Settlement adopted in D.93-03-021. Section 10.3 of the Affiliate Settlement provides that:

"No Affiliate QF Contract shall be amended without prior CPUC approval; except that, if SCEcorp, or any subsidiary of SCEcorp divests its ownership interest in an Affiliate QF Project, the requirement for prior

² Edison filed an errata to resolve the asserted inaccuracy. (See Footnote 1, *supra*.)

CPUC approval as set forth in this Section 10.3 shall no longer apply to that Affiliate QF project." (48 CPUC2d 382.)

Edison states its position with respect to the applicability of this policy, as well as the position of ORA, as follows:

"Although GMEC, GEMLP and EMP are affiliates of Edison, Edison believes that the Settlement Agreement does not constitute a 'contract modification' within the meaning of the QF Affiliate Settlement Agreement (the 'Affiliate Settlement') (approved in D.93-03-021 [March 10, 1993]). Edison accordingly also believes that the Affiliate Settlement does not require Edison to obtain preapproval of the Settlement Agreement by the Commission. Edison has nonetheless filed this Application in light of the position of the Organization [sic] of Ratepayer Advocates ('ORA') that the Affiliate Settlement mandates that Edison obtain advance approval by the Commission of the Settlement Agreement." (Application, p. 2, Footnote 1.)

Edison has acceded to Commission pre-approval of the GEMEC Settlement, notwithstanding its position that such pre-approval is not required. We will exercise our discretion to consider pre-approval of the GEMEC settlement without making findings with respect to whether it constitutes a contract amendment within the meaning of the Affiliate Settlement, or whether pre-approval is required by the Affiliate Settlement. We find this promotes administrative efficiency and is therefore appropriate.

4.2 Reasonableness of the GEMEC Settlement

When GEMEC ceased operating the project in March 1994, it became obligated to refund to Edison the difference between capacity payments calculated and made by Edison under the contract using the assumption that the contract capacity would be provided for the contract term of 30 years, and what Edison would have paid for contract capacity based on a commitment to provide capacity for only the 10 years that the project actually operated. The contract also required GEMEC to reimburse Edison for transmission charges paid to IID on GEMEC's behalf to cover the cost of delivering GEMEC's power from the project site to Edison's service territory.

Edison has calculated that the GEMEC Settlement provides it with 99.2% of the amount owed for transmission service charges and for capacity repayments as of April 18, 1995, the date that Edison declared the project abandoned. If interest is added to the amount owed for capacity repayments from the date of the declaration of abandonment to the effective date of the GEMEC Settlement, Edison will receive 88.5% of the total amount owed. Edison believes that both percentages are higher than it could have hoped to receive even if it had prevailed at trial, taking into account costs of preparing for trial and trying the case. Edison estimates that litigation costs could have exceeded 10% of its recovery. In addition, according to Edison, both percentages are much higher than the percentage of the claim that Edison would receive under the Bankruptcy Code had GEMEC filed for bankruptcy protection. Moreover, the GEMEC Settlement eliminates the risk that if the lawsuit went to trial and defendants prevailed, Edison, and ultimately its ratepayers, could have received no compensation whatsoever for capacity overpayments and transmission service charges paid by Edison under the contract. Edison could have been found liable for \$333,548 due to the allegations that Edison unjustifiably denied GEMEC's uncontrollable force claims.

Based on the foregoing, Edison concludes that the GEMEC Settlement falls within the range of possible outcomes had the lawsuit proceeded to trial or GEMEC filed for bankruptcy protection. ORA essentially agrees with this assessment. ORA believes that except for the discrepancy over the accuracy of statements in the application regarding documents presented in pre-lawsuit negotiations, the GEMEC Settlement lies within the range of reasonable possible litigation outcomes. ORA states that absent the discrepancy, it probably would have concluded that the settlement is reasonable.

In considering the settlement, Edison considered the possibility that a trier of fact in civil litigation could be confused by the complex contractual claims at issue. Edison also noted that the settlement's provision for a declaration that the project is abandoned reduces risks associated with the possibility that another party could assume the contract. Edison asserts that it endeavored to conduct settlement with a representative

from the non-Mission Energy side of the GEMEC partnership, and that the settlement results from arm's-length negotiations.

As noted above, Edison has submitted an errata to the application which resolves discrepancies noted by ORA. The record is persuasive that the GEMEC Settlement falls within the range of possible litigation and bankruptcy outcomes. If the settlement is approved, Edison will recover most of the amount it could have hoped to recover through litigation, without the risks inherent in litigation and in Bankruptcy Court. We conclude that the GEMEC Settlement should be found reasonable on that basis.

Under our traditional ratemaking practice, proceeds from the resolution of the GEMEC dispute would be credited to Edison's Energy Cost Adjustment Clause (ECAC) balancing account. By D.97-10-057 dated October 22, 1997, the Commission ordered that the ECAC mechanism be eliminated effective January 1, 1998, and that any remaining balance in the ECAC account as of December 31, 1997 be transferred to the interim Transition Cost Balancing Account (TCBA). In A.96-08-001 et al., the Commission is considering termination of the interim TCBA and implementation of a more permanent TCBA. We will provide that if Edison receives the GEMEC settlement proceeds on or before December 31, 1997, it shall enter the amount of the proceeds as a credit to the ECAC balancing account. If Edison receives the proceeds after December 31, 1997, it shall credit the amount to the interim TCBA or the TCBA as appropriate.

Findings of Fact

1. Edison has acceded to Commission pre-approval of the GEMEC Settlement.
2. When GEMEC ceased operating the project in March 1994, it became obligated to refund to Edison both excess capacity payments and transmission charges paid to IID on GEMEC's behalf.
3. The GEMEC Settlement provides Edison with 88.5% of the amount owed by GEMEC for transmission service charges and for capacity repayments as of the date that Edison declared the project abandoned, including interest on the amount owed for capacity repayments between the declaration of abandonment and the effective date of

the GEMEC Settlement. The GEMEC Settlement provides Edison with 99% of the total amount owed excluding interest.

4. The GEMEC Settlement falls within the range of possible litigation and bankruptcy outcomes.

5. Edison has submitted an errata to the application which resolves discrepancies in statements regarding the availability of GEMEC financial documents that were noted by ORA.

Conclusions of Law

1. The Commission may elect to consider approval of the GEMEC Settlement without making a finding that the settlement is, or constitutes, a contract amendment within the meaning of the Affiliate Settlement.

2. The Commission should pre-approve the GEMEC Settlement as reasonable.

O R D E R

IT IS ORDERED that:

1. The April 15, 1997 settlement agreement between Southern California Edison Company (Edison) and GEO East Mesa Electric Company, Geo East Mesa Limited Partnership, New East Mesa Limited, EMP Inc., and Credit Suisse is approved.

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2. If Edison receives the proceeds from the settlement agreement approved in Ordering Paragraph 1 on or before December 31, 1997, it shall credit the amount of the proceeds to the Energy Cost Adjustment Clause balancing account. If Edison receives the settlement proceeds after December 31, 1997, it shall credit the amount of the proceeds to the interim or regular Transition Cost Balancing Account as appropriate.

3. Application 97-08-055 is granted, and the proceeding is closed.

This order is effective today.

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

P. GREGORY CONLON
President

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

RICHARD A. BILAS

Commissioners