ALJ/BDP/sid

Mailed 6/5/98

Decision 98-06-021 June 4, 1998

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 Proposed Settlements and Power Purchase Agreement Amendments Between Edison and Wind Power Partners 1993, L.P., Wintec, Ltd., and BNY Western Trust Company; (2) Authorizing Edison's Recovery of Payments Under the Proposed Settlements and Amendments.

ORIGINAL

Application 97-08-015
(Filed August 11, 1997)

O P I N I O N

Summary

Southern California Edison Company (Edison) seeks *ex parte* approval of a proposed settlement of certain disputes through the amendment of four firm-capacity power purchase agreements (PPAs) based on Interim Standard Offer No. 4. The PPAs relate to wind energy small power production facilities located in Riverside County near Palm Springs, California (Projects). The disputes concern a provision in the PPAs providing Edison the right to require the Projects to demonstrate annually the ability to deliver contract capacity. The amount in controversy with respect to the disputes is approximately $11 million (July 1, 1997, net present value (NPV)).

To resolve these disputes, Edison and the other parties to the PPAs entered into a separate settlement agreement and amendment for each contract. Contingent on Commission approval, each PPA will be amended to eliminate an annual firm capacity testing provision in exchange for a 10% reduction in the

firm capacity price. The Projects will remain subject to the performance requirements under the PPAs.

The proposed settlement and restructuring will benefit Edison's customers as follows: (1) the Interim Standard Offer No. 4-based firm capacity prices under the PPAs will be reduced by 10% effective June 1, 1996 (resulting in estimated customer savings of approximately $1.0 million NPV); (2) the risks and expenses associated with litigating the parties' disputes will be avoided; and (3) the fuel diversity and environmental benefits associated with the projects' generating facilities will be retained.

The application is granted.

Procedural Summary

Edison filed this application on August 11, 1997. Notice of the application appeared in the Commission's Daily Calendar on August 15, 1997. On September 15, 1997, the Office of Ratepayer Advocates (ORA) filed a protest of the application. On October 2, 1997, Edison and LG&E Power 21 Incorporated, a general partner in Windpower Partners 1993, L.P. (Qualifying Facilities (QF) parties) filed a reply to ORA's protest.

The parties agreed that evidentiary hearing was not required. On February 9, 1998, opening briefs were filed by Edison and ORA. On February 25, 1998, reply briefs were filed by Edison, ORA and LG&E Power 21 Incorporated, and this matter was submitted for decision.

Along with the application and settlement agreement, Edison filed the testimony of its employees who negotiated the settlement and who evaluated ratepayer benefits of the settlement. (Exhibits SCE-1 and SCE-2.)

Edison moved to have the settlement agreement and the supporting analyses received under seal. Edison argued that if other QFs examined the details of the settlement agreement and the financial analysis, Edison would be at

a disadvantage in pending negotiations with other QFs. The motion to seal was unopposed. By an Administrative Law Judge's Ruling dated September 12, 1997, redacted portions of the Edison application and exhibits were placed under seal through October 1, 1998, subject to renewal. Accordingly, we will be circumspect in our discussion of the Settlement Agreement and its analysis.

Power Purchase Agreements (PPAs)

Between January, 1984 and September, 1986, Edison and Renewable Energy Ventures, Inc. executed four separate firm-capacity PPAs based on Interim Standard Offer No. 4 (ISO4), relating to wind energy projects located in Riverside County near Palm Springs, California. The projects are identified as QFID Nos. 6030, 6035, 6118, and 6213, respectively. The PPAs were subsequently amended and assigned to WPP-93 as to QFID Nos. 6030, 6035, and 6118 and to BNY as trustee for the benefit of WPP-93 and Wintec as to QFID No. 6213.

Each PPA has a term of 30 years and provides for energy payments for the first 10 years of the contract (first period) to be based on Edison's Forecast of Annual Marginal Cost of Energy, as then approved by the Commission. Energy payments for the remaining terms of the PPA are based upon Edison's Standard Offer No. 1 (SO1) avoided-cost based prices, as approved by the Commission. The projects are beyond the contractual first period and receive energy payments based upon SO1 avoided-cost prices. The projects' current firm capacity prices range from $137 per kilowatt year (kW/yr.) (QFID No. 6030) to $155 per kW/yr. (QFID No. 6118). Subject to Commission approval and to achieve immediate customer savings from the settlements, the parties agreed pursuant to the settlement agreements to reduce the projects' firm capacity prices by 10%, retroactively effective to June 1, 1996. The reduced firm capacity prices lower the amount of capacity payments made to the projects, and provide expected

customer savings of approximately $1.0 million over the remaining terms of the contracts.[1]

Edison's Annual Capacity Demonstration Program

The ISO4 and many of Edison's negotiated firm-capacity contracts contain a provision which requires the QF to demonstrate annually at Edison's request the ability to provide firm contract capacity. To administer this provision, Edison developed an Annual Contract Capacity Demonstration Program which requires the firm-capacity QF to deliver 100% of its firm contract capacity for each 15-minute metering interval over a specified period of time (typically six hours) during Edison's system peak period.

The Disputes

Edison first requested the projects to perform demonstration tests under Edison's Annual Contract Capacity Demonstration Program in 1993, approximately seven to eight years after they commenced deliveries under the contracts. The projects passed the first tests in 1993, but the owners disputed Edison's right to schedule and conduct the tests. The projects failed their 1995 demonstration tests because they were not able to deliver 100% of contract capacity during each 15-minute interval over the test period due to low wind speeds. Edison thereafter sought to derate the contract capacity of each project to zero. Edison also invoiced the projects a total of $2,030,099, representing the amount of capacity overpayments that would have to be repaid in connection with the derations. The project owners continued to dispute Edison's rights to schedule and conduct the demonstration test and to derate the projects' contract capacities. The owners also claimed that the low wind speeds constituted an

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[1] July 1, 1997 NPV.

uncontrollable force which excused the Projects from their obligations to deliver contract capacity (Exhibit SCE-1).

Edison and the project representatives engaged in negotiations to settle their disputes. The resulting Settlement Agreements were provided to the Commission under seal (Exhibit SCE-2).

Position of Edison

Edison states that to demonstrate the reasonableness of the settlements, it performed an economic analysis to determine the total customer costs that would likely result from: (1) Edison being able to sustain its position that the contract capacity of each of the four projects should be reduced to zero (Edison Prevails Scenario), (2) the proposed settlement and restructuring (Settlement Scenario) and (3) the project representatives being able to sustain their position that the contract capacity of each of the four projects should not be reduced whatsoever (WPP-93 Prevails Scenario). Edison's economic analysis of the settlement and restructuring is discussed in detail in its prepared testimony.

Edison's analysis compared the expected total contract capacity costs of the Settlement Scenario to the expected total contract capacity costs of the Edison Prevails Scenario and WPP-93 Prevails Scenario. The expected contract capacity costs under the WPP-93 Prevails scenario are approximately $13.4 million (July 1, 1997, NPV), while the expected total customer costs under the Edison Prevails Scenario are approximately $2.3 million. The expected total customer costs under the Settlement Scenario are approximately $12.4 million, which is almost $1 million less than the WPP-93 Prevails Scenario and within the range of possible outcomes. Thus, according to Edison, the settlement agreements are expected to save Edison's customers approximately $1 million as compared to the scenario when Edison would not be able to derate the contract capacities of the projects.

Position of ORA

ORA argues that the settlement unreasonably eliminates an important ratepayer protection in the contracts between Edison and the QF parties. ORA's main concern is the elimination of a provision in the PPAs regarding the QF parties' obligation to schedule and demonstrate their ability to deliver contract capacity. ORA contends that the proposed settlement agreement unreasonably eliminates the provision that requires the QF parties to schedule and demonstrate their ability to provide firm capacity.

Further, ORA argues that the main issue is the standard the Commission should apply in eliminating an important ratepayer protection in a power purchase agreement between Edison and the QF parties. According to ORA, the simple conclusory assertion that a dispute exists should not be sufficient grounds to eliminate an important ratepayer protection. ORA submits that otherwise, the Commission would be setting a precedent that would encourage QFs to simply assert a dispute in order to avoid enforcement of an unfavorable ratepayer protection provision.

ORA submits that in deciding this matter, the Commission should first find that the provision regarding the QF parties' obligation to schedule and demonstrate their ability to deliver contract capacity is an essential element that protects ratepayer interests by ensuring that the QF parties are able to perform as required under the terms and conditions of the contracts. Second, the Commission should examine the merits of the "dispute" put forth in Edison's application. In doing so, the Commission should examine the existing factual record.[2] ORA submits that the "wind" excuse is simply a red herring that should

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[2] In its opening brief at p. 1, Edison asserts that "there are no factual issues to resolve." ORA does not fully agree with this statement. For instance, ORA believes that a factual

Footnote continued on next page

be dismissed. According to ORA, the Commission should not eliminate an important ratepayer protection based on conclusory assertions, abstract arguments or invocation of inapplicable "uncontrollable force" doctrine. According to ORA, low wind speed does not excuse the QF parties' breach of the implied covenant of good faith and fair dealing. ORA believes that the contract terms and conditions clearly provide Edison a right to schedule and conduct a demonstration test and impose a duty upon the QF parties to negotiate in good faith a schedule and demonstration of their ability to provide the contract capacity.

Position of QF Parties

The QF parties assert that the settlements are reasonable because if they are forced to litigate this matter, they intend to claim that the unpredictability of wind speeds not only invalidates Edison's capacity demonstration tests and Edison's resulting derations but also invalidates other derations made by Edison. If prior derations are successfully invalidated in such litigation, the QF parties estimate that the QF parties will recover an additional $16 million.

The QF parties contend that the capacity demonstration testing provisions were never intended to apply to wind projects. They argue that the PPAs were not specifically written for wind projects but instead were originally written in generic form to apply to numerous and varied QF projects including cogeneration, biomass and small hydroelectric projects. According to the QF parties, the fact that Edison did not request demonstration tests of the wind

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issue exists as to the characterization and merits of the "dispute" asserted by Edison surrounding the capacity demonstration test. However, ORA agreed that a hearing was not necessary to develop further facts because sufficient evidence exists in Edison's application to resolve this matter.

projects until approximately seven to eight years after commencement of deliveries under the PPAs is evidence that Edison did not intend those provisions to apply to wind projects.

The QF parties argue that if the demonstration testing provisions were intended by Edison or any other party to apply to wind projects at all, which they were not, then they were merely intended to ensure the operability of the QF parties' equipment when there is blowing wind and not to require the QF parties to guaranty that the wind would blow at a constant speed at all times.

Further, the QF parties dispute ORA's assertion that because low wind speeds are foreseeable, the QF parties cannot be excused from performance as a result of low wind speeds. The QF parties point out that Section 15 of each PPA provides that a party will be excused from contract performance and will not be in default if performance is prevented by an "uncontrollable force." The PPAs define uncontrollable force as "any occurrence beyond the control of a party which causes that party to be unable to perform its obligations hereunder and which a party has been unable to overcome by the exercise of due diligence . . . ." The definition then includes several non-exclusive examples, many of which are weather-related.

The QF parties argue that there is no requirement in the PPAs that low wind speeds must be unforeseeable in order to constitute an uncontrollable force. The QF parties contend that many of the examples described in the definition of that phrase are as foreseeable as wind speed fluctuations, including floods, droughts, and storms. According to QFs, all of these events are foreseeable; one just does not know exactly when they will occur. The same is true for wind speed fluctuations.

Therefore, the QF parties will contend in any litigation that even if the demonstration tests were properly conducted, the QF parties' performance under

those tests was excused because wind is an uncontrollable force as defined in the PPAs.

The QF parties contest ORA's statement that the basis of the dispute lacks "merit" and the QF parties have breached the implied covenant of good faith and fair dealing in the PPAs for challenging Edison's right to unilaterally schedule a demonstration test without agreement with the QF parties regarding the timing and protocol. The QF parties state that in fact, in spite of their objections, they had agreed to schedule tests, if appropriate testing procedures could be mutually agreed upon with Edison.

The QF parties argue that ORA improperly seeks to have the Commission go beyond evaluating the reasonableness of the settlement and become both judge and jury to determine that the QF parties have breached the PPAs. The QF parties submit that the Commission has repeatedly refused to review PPAs for breach of contract:

> "From the very inception of the development of the standard offers and related contracts between QFs and utilities, we have viewed the resulting agreements as legally enforceable contracts between two equal parties. We have been very hesitant to engage in reviews of these agreements because the resolution of contractual disputes is an area that our laws and traditions have delegated to the courts and similar entities for centuries." (D.89-11-062, mimeo. at p. 19.)

Further, the Commission has stated:

> "Once the QF and the utility signed a contract . . . we had hoped that our subsequent role would be limited to the usual review of the reasonableness of the utility's purchases and administration of its contracts with QFs. If later disputes developed between the utility and the QF about the performance of the contract, we presumed that the parties would turn to the common resources for resolving such disputes—negotiations, arbitrations, and, if necessary, the courts." (D.89-04-081, 31 CPUC2d 549, 562-563.)

Thus, according to the QF parties, the Commission should not substitute its judgment for the parties' judgment regarding the validity of the dispute and the resolution of their differences as argued by ORA. Rather, the Commission should follow its precedents and determine whether the settlement is reasonable on an *ex parte* basis, given the range of possible outcomes.[3]

Discussion

This application requires us to evaluate the reasonableness of a settlement designed to resolve a dispute between Edison and the parties involving issues of contract interpretation. As we have recently noted in a previous decision involving QF contract interpretation (D.98-04-023) the mere existence of a dispute or a "colorable claim" regarding a contract does not ensure that any settlement of that contract is reasonable. The "colorable claim" must raise "substantive issues of law and fact." D.98-04-023, citing to a previous Commission decision, states that:

"Before a utility enters into any renegotiation of a power purchase agreement, it presumably has evaluated the strength of the other party's position. If the other party does not have a unilateral right to make modifications to the contract, then the utility should determine what reasonable concessions can be obtained in exchange for the contract modification sought by the other party." (D.98-04-023, p. 13 citing to D.87-07-026.) As ORA notes, the simple conclusory assertion that a dispute exists is not sufficient grounds to modify a contract.

Turning to the proposed settlement agreements before us in this proceeding, we believe that the settlement of the first issue in dispute, the elimination of the demonstration test for these specific QFs is reasonable. The

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[3] All parties have agreed that evidentiary hearings are not required in this proceeding.

compromise proposed by the settlement falls within the range of possible outcomes. Had the dispute been litigated, the trier of fact could have found that the test requirement set forth in the PPA was not intended by the parties to apply to wind projects. A trier of fact could have found that the QFs must agree to the protocols of any test to which they are subject. Although the validity of the claims made by the QF parties may not have been upheld, there was enough uncertainty, given the history of this project, for Edison to at least enter into settlement negotiations. Thus, the settlements eliminate the risks associated with litigating these issues, and also provide for a meaningful reduction in the capacity prices paid to these QFs. Under these circumstances, we conclude that the settlements fall within the range of reasonable possible outcomes notwithstanding the test's elimination.

With regards to the parties second claim, that low wind speeds constitute an uncontrollable force under the PPA that would excuse the QFs' performances under the demonstration tests, we agree with ORA and Edison we should accord if little, if any weight in determining the need to settle this dispute. As Edison noted, it "strenuously disagrees with [the parties] position, [and] accorded it virtually no weight in negotiating these settlements."

As Edison points out, the PPAs in question each have specific provisions containing performance requirements that the QF must meet in order to earn its firm capacity payments and capacity bonus payments. These provisions, which have not been eliminated in the settlements, will continue to provide Edison with a basis for derating the QFs' projects if the performance requirements are not met. Furthermore, the specific facts and circumstances of the particular dispute being settled herein are readily distinguishable from Edison's other firm capacity QF contracts, so elimination of the capacity demonstration test for these QFs will not affect administration of Edison's other QF contracts.

None of the parties are affiliated with Edison and we are satisfied that the proposed settlement agreements are a result of good faith, arms-length negotiations.

Accordingly, we conclude that the settlement agreements should be adopted. The settlement agreements are reasonable in light of the whole record, consistent with the law, and in the public interest. (Rule 51.1(e), Rules of Practice and Procedure.)

Findings of Fact

1. Edison and the QF parties have proposed a settlement of their contract dispute.

2. As part of the settlement, the contracts will be amended to eliminate an annual capacity demonstration testing provision in exchange for a 10% reduction in the contract firm capacity price.

3. Edison estimates that the 10% reduction in the firm capacity price will result in customer savings of $1.0 million NPV.

4. There are no material facts in dispute that require an evidentiary hearing.

5. The deletion of the demonstration testing provision does not excuse the QF parties from delivering the required capacity under the PPAs. The QF parties must still deliver the required capacity measured monthly throughout the term of the PPAs.

6. The only change to the PPAs, besides the reduction in payments to the QF parties to the benefit of Edison and its customers, is that Edison will no longer be able to require the QF parties to demonstrate an ability to provide contract capacity at any given moment in the absence of wind.

Conclusions of Law

1. The mere existence of a dispute or a "colorable claim" regarding a contract does not ensure that any settlement of that contract is reasonable. The disputed claim must raise "substantive issues of law and fact."

2. The proposed settlements are reasonable because the instant PPAs are Edison's least expensive ISO4 contracts and are therefore advantageous to ratepayers. These PPAs provide for Edison to pay capacity payments to the QF parties that are approximately 40% to 50% lower than capacity payments Edison must pay under other ISO4 contracts.

3. The proposed settlement agreements are within the range of possible outcomes.

4. None of the QF parties are affiliated in any way with Edison and the proposed settlement agreements are a result of good faith, arms-length negotiations.

5. The proposed settlement agreements (Exhibit SCE-2) are in the public interest and should be approved by the Commission. There is no need for evidentiary hearing.

O R D E R

IT IS ORDERED that:

1. The proposed settlement agreements and the amendments to the purchased power agreements (PPAs) between Southern California Edison Company and Windpower Partners 1993, LP, contained in the settlement agreements filed under seal with Application (A.) 97-08-015 as Exhibit SCE-2, are approved.

2. Southern California Edison Company (Edison) shall recover all payments to be made by it pursuant to the settlement agreements and amended PPAs subject to Edison's prudent administration of the amended contracts.

3. The motion of Edison for a protective order is granted. The settlement information redacted from the application and exhibits, which documents in unredacted form have been submitted as a sealed attachment to the motion for protective order, shall remain under seal for a period to and including October 31, 1998, and during such period shall not be made accessible or disclosed to anyone other than Commission staff except on the further order or ruling of the Commission, the Assigned Commissioner, the assigned Administrative Law Judge (ALJ) or the ALJ then designated as Law and Motion Judge.

4. Application 97-08-015 is closed.

This order is effective today.

Dated June 4, 1998, at San Francisco, California.

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