ALJ/MEG/jva * **Mailed 9/18/98**

Decision 98-09-073 September 17, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application and Request of Southern California Edison Company (U 338-E) for Order Approving Termination Agreement For Termination of ISO4 Power Purchase Agreements Between Southern California Edison Company and Harbor Cogeneration Company.	ORIGINAL Application 97-12-043 (Filed December 23, 1997)

(See Appendix A for List of Appearances.)

OPINION

Summary

By this decision, we approve Southern California Edison Company's (Edison) proposed buyout and termination of a 1985 power purchase agreement with Harbor Cogeneration Company (Harbor). Expected customer benefits from the buyout are $27.4 million in net present value (NPV). Edison agrees to forego any shareholder incentives for this application.

We find no merit to Southern California Gas Company's (SoCal) arguments that public necessity requires Commission intervention on behalf of gas ratepayers in this case.

Background

Harbor is a qualifying facility (QF).[1] It is currently owned 70% by Indeck North American Power Fund L.P. (Indeck) and 30% by South Coast Energy

[1] 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.

Footnote continued on next page

Company, a wholly owned subsidiary of Edison Mission Energy.[2] Harbor operates a 83.4 megawatt (MW) cogeneration facility located in the vicinity of the Port of Long Beach, California. Harbor leases its land on the Wilmington Oil Field, which is owned by the Port of Long Beach ("the Port"). The Port has a long-term contract to purchase steam from Harbor to inject into the portion of the oil field that the Port owns for enhanced oil recovery (EOR).

Edison and Harbor in April 1985 executed an Interim Standard Offer 4 (ISO4) power purchase agreement, the standard at that time for long-term contracts between electric utilities and QFs. Harbor achieved firm operation on April 12, 1989. Under the terms of the agreement, Edison purchases 76.4 MWs of firm capacity and associated energy from the Harbor cogeneration facility until April 12, 2019, i.e., 30 years from the date of firm operation.

Capacity payments are fixed for the life of the contract at $175 per kilowatt (kWh) year, subject to the firm capacity performance requirements defined in the contract. During the first 10 years of firm operation, energy prices are based 80% on Commission-approved variable avoided costs and 20% on a fixed forecast specified in the contract. The fixed forecast of energy prices increases from

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Utilities are required to purchase this power at prices approved by state regulatory agencies.

[2] The Power Purchase Agreement (PPA) is contained in Exhibit (Exh.) 7. The original parties to the PPA were Edison and Champlin Petroleum Company, which later changed its name to Union Pacific Resource Company (UPRC). In 1987, UPRC and South Coast Energy Company, a wholly-owned subsidiary of Edison Mission Energy, entered into a partnership that created the Harbor Cogeneration Company to own and operate the plant. Edison Mission Energy is a wholly-owned subsidiary of The Mission Group, which is a wholly-owned subsidiary of Edison International, Edison's parent company. In 1993, UPRC sold both its 70% interest in Harbor and portions of the Wilmington Oil Field which it owned to the Port of Long Beach. In 1995, the Port sold its 70% interest in Harbor to Indeck.

7.6 cents per kWh in the first year to 14.6 cents per kWh in the tenth year. Energy prices during subsequent years (after April 12, 1999) are entirely variable, and are set equal to Edison's posted short-run avoided costs.

In October, 1987, Harbor entered into a 15-year gas transportation agreement with SoCal, referred to by the parties as the long-term gas contract or "LTK". This contract was approved by the Commission on January 28, 1988 via Resolution G-2770. It went into effect on October 1, 1988 and terminates on September 30, 2003.

On December 23, 1997, Edison filed an application for approval of a buyout agreement that would terminate the ISO4 contract between Edison and Harbor ("termination agreement"). Edison also filed an accompanying motion for a protective order that would place under seal most of the application and supporting documents.

On February 2, 1998, the assigned Commissioner and assigned Administrative Law Judge (ALJ) Steven Weissman issued a joint ruling to (1) address Edison's motion for protective order; (2) schedule a prehearing conference; and (3) announce a preliminary categorization of the proceeding as ratesetting, pursuant to the Commission's Rules of Practice and Procedure (Rule) 6. In their ruling, the assigned Commissioner and ALJ found that only a small portion of the documents filed by Edison qualified for protection.

On February 11, 1998 Edison requested automatic reassignment of the assigned ALJ pursuant to Rule 63.2(b). On February 19, 1998, the proceeding was reassigned to ALJ Meg Gottstein by Chief Administrative Law Judge Ruling.

On March 6, 1998, Edison filed a motion for Commission reconsideration of the February 2, 1998 joint ruling with regard to the resolution of its motion for protective order. On April 15, 1998, the assigned Commissioner and ALJ issued a joint ruling that denied Edison's motion, but corrected some inadvertent errors and omissions in the February 2, 1998 ruling. Edison appealed that joint ruling to the full Commission on April 22, 1998.[3]

On March 30, 1998, the Office of the Ratepayer Advocates (ORA) filed a protest to the application. ORA based the protest on several grounds, including ORA's contention that Edison's calculation of ratepayer benefits under the termination agreement was flawed. A prehearing conference was held on April 1, 1998. The assigned Commissioner presided over the prehearing conference and issued a Scoping Memo on April 15, 1998.

On April 14, 1998, Edison filed its reply to ORA's protest. Edison and ORA thereafter exchanged documents and met and conferred about the contentions contained in ORA's protest. By these conversations and exchange of documents, Edison and ORA were able to resolve the protested issues and further agreed that Edison would waive any shareholder incentive for this application.[4] Edison filed to withdraw its request for shareholder incentives on May 8, 1998. ORA withdrew its protest on May 11, 1998.

SoCal filed testimony on May 8, 1998 and Edison filed rebuttal on May 18, 1998.

Three days of evidentiary hearings were held on May 26, 27 and 28, 1998. Opening briefs were filed by Edison, Indeck, Pacific Gas and Electric Company (PG&E) and SoCal on June 26, 1998. Reply briefs were filed by Edison, SoCal,

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3 The assigned Commissioner and ALJ addressed this motion on the first day of evidentiary hearings, and directed Edison to make further modifications to the public version of its testimony.

4 In D.95-12-063, as modified by D.96-01-009, the Commission determined that "[w]hen a QF contract is renegotiated, shareholders should retain 10% of the resulting ratepayer benefits, which will be reflected by an adjustment to the competitive transition charge if the modification is approved by the Commission." (Conclusion of Law 74.)

Indeck and PG&E on July 10, 1998. Closing arguments were held before the assigned Commissioner and ALJ on July 14, 1998. Today's decision is completed within the timeframe set forth in assigned Commissioner's Scoping Memo.

Pursuant to Public Utilities (PU) Code Section 311 and our Rules of Practice and Procedure (California Code of Regulations, Title 20, Rules 77 to 77.6), the proposed decision of ALJ Gottstein was issued before today's decision. SoCal filed comments on the proposed decision, and Edison, Indeck and The Utility Reform Network filed replies.[5] In response to those comments we have made minor clerical corrections and corrected minor numerical errors, but have made no substantive changes to the ALJ's proposed decision.

Before turning to the issues in this case, we remind Edison that our Rules do not provide for interlocutory appeals of rulings issued by the presiding officer, e.g., the assigned Commissioner or ALJ. Moreover, our Rules clearly state that the presiding officer has authority to rule upon "all objections or motions which do not involve final determination of proceedings." (Rule 63.) The Commission has articulated its reluctance to review evidentiary and procedural rulings before the proceeding has been submitted, reasoning as follows:

> "There is no appeal from a procedural or evidentiary ruling of a presiding officer prior to consideration by the Commission of the entire merits of the matter. The primary reasons for this rule are to prevent piecemeal disposition of litigation and to prevent litigants from frustrating the Commission in the performance of its regulatory functions by inundating the Commission with

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[5] SoCal filed its comments at the Commission's Docket Office one day late, but served all parties on the date that the comments were due. Since no parties were disadvantaged by SoCal's late filing, we grant SoCal's motion for leave to accept its late-filed comments.

interlocutory appeals on procedural and evidentiary matters. (55 CPUC2d 672, 676.)

"Parties who contemplate appealing a ruling with which they are dissatisfied should recognize that we frown on such a practice, and view this kind of a decision as the rare exception rather than the rule." (Ibid.)

"...We have a further reason to assure the presiding officer adequate power to control a hearing. We now have to decide, with few exceptions, adjudicatory cases within 12 months of filing and other matters within 18 months. An impotent presiding officer faced with an intransigent litigant could not manage the case expeditiously, resulting, perhaps, in actual harm to other participants." (D.98-03-073, mimeo. at 126.)

Edison filed two appeals of assigned Commissioner and ALJ rulings in this case. In both instances, Edison presented new arguments to augment its rationale for confidential treatment of portions of its application and exhibits. In both instances, we declined to review the rulings, consistent with the policy articulated above. The public would have been better served if Edison's initial motion for protective order had presented a clear justification for redaction on a section-by-section basis, rather than a general appeal for blanket protection. We put Edison on notice that the presiding officer may impose sanctions for bad faith actions. Repetitive appeals of assigned Commissioner and ALJ rulings may, in future cases, warrant consideration of sanctions by the presiding officer.

Project Viability and Ratepayer Benefits

In past applications similar to this one, the Commission has required a persuasive showing that: (1) the QF generating facility is a viable one that would not be likely to shut down prior to completing the contract and (2) a buyout will benefit ratepayers more than keeping the contract in place.[6]

Since achieving firm operation in 1989, Harbor has performed at a capacity factor exceeding 93% in each year, excepting its first year and 1995 when a scheduled major overhaul was performed. (Exhibit (Exh.) 8, p. 5.) Edison retained a technical consultant, RanBo Energy Associates (RanBo) to confirm the continuing viability of Harbor's cogeneration plant over the remainder of the contract term. RanBo visited the site, examined equipment design and reliability, fuel supply, staffing, operating data, operational costs, environmental and regulatory compliance, including the availability of a steam host, and maintenance programs utilized by the plant. RanBo also reviewed Harbor's financial statements and created an independent economic proforma model for the facility, based on previous operating results at the facility and projections through the term of the contract. Based on its analysis, RanBo concludes that Harbor would be technically and economically viable through the term of the power purchase agreement. (Exh. 6, pp. 13-19; Exh. 10.)

To evaluate ratepayer benefits, Edison performed economic analyses that considered a range of possible outcomes assuming that Harbor would operate for the full contract term, including "expected" and "worst" case scenarios. These benefits result from the replacement of Harbor's high energy and capacity prices under the ISO4 contract with lower-priced energy and capacity based on Edison's projected replacement costs, net of the termination payments. For the

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6 See San Diego Gas & Electric Company, Decision (D.) 94-12-038; Edison, D.95-10-041, D. 95-11-058, D.97-02-013, D.97-02-050, D.98-02-112; PG&E, D.98-01-016; 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).

different cases, Edison assumed alternative estimates of Harbor's production levels and capacity payments based on the history of Harbor's operations and alternative forecasts of replacement energy and capacity prices. Based on Edison's analysis, the termination agreement yields total savings to Edison's customers in the expected case of $27.4 million (January 1, 1998 NPV, 10% discount rate). Under Edison's worst case scenario, the termination agreement yields expected savings to Edison's customers of $16.4 million in NPV. (Exh. 6, pp. 20-21.)

In its testimony, SoCal asserts that the termination agreement will harm SoCal and its ratepayers, and recommends that the Commission mitigate that harm if the termination agreement is approved. (Exh. 19, 19A.) In particular, SoCal argues that its ratepayers will be disadvantaged with the termination of the contract because Harbor will "simply have no economic reason to operate." (Opening Brief, p. 3.) According to SoCal, termination of the power purchase agreement would "set in motion a chain of events, much like dominoes falling, that would result in Harbor being put in a position to invoke the early termination provisions of the LTK to avoid paying some $41 million in revenue to SoCal, 95% of which will be borne by its ratepayers." (Ibid.)

SoCal requests that the Commission require any restructuring of the contract to consider the effects on gas, as well as electric, ratepayers. In this particular case, SoCal requests that the Commission require Edison to make a showing of benefits that includes mitigating the loss of $39 million to gas ratepayers (October 1, 1998 NPV, 5.22% discount rate). This figure represents the ratepayer portion (95%) of transport-or-pay obligations under the LTK and expected tariff revenues throughout the term of the ISO4 contract, i.e., until 2019.

In terms of monetary compensation to gas ratepayers, SoCal requests that Edison be required to put part of the termination payment in escrow to offset the payments due SoCal over the life of the LTK. This amount would be $13 million in NPV, representing SoCal's estimate of the transport-or-pay value of the contract from October 1998 through September 2003. Under SoCal's proposal, Edison would pay this amount to SoCal if Harbor terminated the LTK. Otherwise, funds from the escrow account would be used to pay SoCal for the gas purchased from SoCal by Harbor. (Reporter's Transcript (RT) at 342-345; Exh. 19, p.10.)

Edison, Indeck and PG&E object to SoCal's request for compensation in this case. In their view, SoCal's assertion that the termination agreement will reduce revenues to SoCal is entirely speculative. They believe that the Commission's acceptance of SoCal's position in this case would have a chilling effect on present and future contract restructuring discussions between utilities and gas-fired QFs. Even if harm could be demonstrated, Edison and Indeck contend that SoCal's rights in this case are limited to the provisions of its LTK with Harbor, in particular, to the liquidated damages provisions of Section 5.4.

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 ISO4 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 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 under the existing contract.

Edison has demonstrated to our satisfaction that Harbor meets the Commission's viability criteria and that the buyout will produce substantial cost savings that benefit Edison's electric customers. There is no dispute among the parties with respect to these issues.

What is in dispute is whether the Commission should also consider the impacts of the termination agreement on SoCal's natural gas ratepayers, and what such impacts would be in this case. This is the first application for preapproval of a buyout in which these issues arise, since it is the first that involves a fossil- fueled nonrenewable QF.

As noted in the assigned Commissioner's April 15, 1998 scoping memo, we are currently addressing the issue of gas ratepayer impacts on a generic basis in our electric restructuring proceeding, Rulemaking (R.) 94-04-031/ Investigation (I.) 94-04-032. We allowed SoCal to proceed with discovery and submit testimony on this issue in this proceeding, with the caveat that such permission would not: (1) commit us to a finding that these impacts must be linked to approval of the contract that Edison and Harbor seek in this proceeding or (2) in any way prejudge the matters before us in R.94-04-031/I.94-04-032. Similarly, the criteria we use today in evaluating the reasonableness of the termination agreement will in no way bind us in our consideration of the appropriate criteria to use in the future, an issue we are currently considering in R.94-04-031/ I.94-04-032.

SoCal has brought the issue of natural gas ratepayer impacts before us in the presentation of direct testimony, cross-examination and briefs. In particular, SoCal asks us to find that: (1) gas ratepayers will be harmed by approval of the termination agreement in the amount of $39 million and (2) the Commission should intervene and direct Edison to compensate SoCal ratepayers for at least $13 million of this amount, should Harbor cease operations.

With the above caveats in mind, we have carefully considered the evidence and arguments presented in this proceeding. Before discussing that evidence, we first review our policies regarding EOR contracts, and Commission modifications to those contracts, once approved.

In D.86-12-009, we authorized gas utilities to negotiate long-term transportation agreements with EOR producers, subject to our approval. We did so to provide California's gas utilities "with the tools and flexibility necessary to serve the California EOR market and all other markets and customers with competitive alternatives." (D.86-12-009, 22 CPUC2d 444, 482.) However, we also cautioned SoCal and others that "such long-term contracts engender uncertainties for both the utilities' ratepayers and their shareholders." We went on to explicitly state that "this Commission intends to respect the sanctity of such contracts except in the face of clear public necessity". (*Ibid.*, p. 483.) Accordingly, we waived the provisions of General Order 96-A to the extent that it required that EOR contracts be subject to future modification by the Commission. In doing so, we recognized that the unwarranted modification of a contract by the Commission would "run afoul of the Contract Clause of the United States Constitution...:"

> "If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation, United States Trust Company, 431 U.S. at 22, such as the remedying of a broad and general social or economic problem. Allied Structural Steel Company, 438 U.S., at 247, 249... The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests. Id., at 411-412." (Ibid., p. 484.)

SoCal argues that it is not requesting a modification to its LTK, but rather, protection for its ratepayers because of a "reasonable expectation" that arose from the Commission's approval of the LTK. According to SoCal, this reasonable expectation was that Harbor would pay SoCal to transport gas throughout the ISO4 contract term. (RT at 16-17.)

We disagree. There is no support for the reasonable expectation that SoCal articulates in either the Public Utilities Regulatory Policies Act of 1978 (PURPA) or in our decision approving the LTK. Title I of PURPA sets forth its purposes as the encouragement of "(1) conservation of energy supplied by electric utilities, (2) optimization of the efficient use of facilities and resources by electric utilities, and (3) equitable rates to electric consumers." (Public Law 95-617, 16 USC 2601 et seq., 92 Stat. 3117.) There is no mention of any benefit or expectation to gas suppliers or any other party in the position of SoCal.

In fact, we held in 1983 that standard offer contracts, such as Harbor's contract with Edison, were intended to be "a statement of the rights and obligations of only two parties—the utility and the QF." (D.83-10-093, 13 CPUC2d 84, 130.) This decision was in effect at the time we approved the LTK in 1988. Had we intended to deviate from this policy at the time of approving the LTK, we would have expressly stated so. Similarly, had our approval of the LTK contemplated that SoCal would transport gas to Harbor throughout the term of the ISO4 between Edison and Harbor, we would have articulated that expectation. However, our approval of the LTK nowhere mentions the contract between Harbor and Edison and includes no reference to the term of that contract.

In sum, we find no basis for SoCal's assumption that PURPA or Commission policy afforded it a reasonable expectation of transporting gas to Harbor throughout the term of the ISO4 contract. As discussed above, the only reasonable expectation that SoCal could have derived from Commission policy is that the Commission would not intervene to modify the LTK, once approved.

Section 5.4 of the LTK directly addresses the risk that Harbor could become uneconomic before the end of the contract term and cease operations. Under those circumstances, Harbor is obligated to pay SoCal one year of transport-or-pay obligation, estimated at $3 million:

> "After commencement, if Customer elects to permanently stop all operations at its Premises because it has become uneconomic to continue its operations, then Customer may terminate this Contract, subject to Customer fulfilling all outstanding contractual obligations including any transport-or-pay obligations, and in addition paying a cancellation charge equivalent to the amount of the transport-or-pay obligation due for one Contract Year from the date of termination using the Daily Transmission Capacity in effect on the date of termination."[7]

In this case, SoCal requests Commission protection against ratepayer harm that is well beyond the estimated $3 million provided for in Section 5.4. In effect, SoCal requests that the Commission secure its payment under the LTK through 2003 even though SoCal freely negotiated alternate cancellation provisions and we approved them. In our view, this constitutes a substantial impairment of a contractual relationship, and must be considered in light of our existing policies, namely, that we can only make such a modification if there is clear evidence of public necessity.

SoCal has failed to demonstrate that public necessity warrants modification of the existing provisions of the LTK. While SoCal asserts that its ratepayers will be greatly harmed by the termination agreement, these assertions are simply not supported by the record.

In particular, SoCal's assertions are based on the presumption that Harbor will stop operating the plant if the current ISO4 contract is terminated. However,

7 In response to SoCal's participation in this case, Harbor offered to secure the Section 5.4 payments to SoCal from a portion of the amounts due Harbor from Edison pursuant to the termination agreement, or by posting a letter of credit naming SoCal as the beneficiary, at SoCal's option. (Exh. 4; RT at 73-74.) SoCal refused the offer.

SoCal's analysis is based on a single, worst-case scenario. (RT at 289-290.) We find that this scenario, and the assumptions underlying it, are not credible.

For example, SoCal asserts that Harbor's future costs to generate electricity will be higher than the price it will be able to obtain for the electricity. In projecting future prices for electricity, however, SoCal assumes that Harbor would be paid the current Palo Verde forward price for the next 21 years. Not only is the use of a single, current price to predict the future overly simplistic, but the evidence in this case indicates that Harbor is likely to get a better selling price selling into the power exchange (PX) than to Palo Verde. This is because delivery at Palo Verde must take into account transmission losses and potential congestion charges associated with transporting the power to the load center. (RT at 165-167.)

SoCal also assumes that Harbor will receive no income from steam produced by its facility from the present to 2019. Yet, the Port of Long Beach currently purchases steam from Harbor's facility to use in EOR operations under a steam sales contract between Harbor and the Port that is currently being renegotiated.[8] While the ultimate outcome of these negotiations cannot be known at this time, there is no evidence to suggest a high probability that the Port will cease its EOR activities altogether or revert to generating steam with its own generators.[9] In fact, the cost of producing steam from the Port's generators

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8 The steam contract between Harbor and the Port terminates if the ISO4 terminates. Harbor has been in negotiations with the Port for a new contract in view of Edison's pending buyout application. Even if those negotiations are unsuccessful, the Port has the option of generating its own steam and purchasing gas from SoCal for its generators. This, in turn, would create new gas sales to SoCal, which would serve to mitigate the alleged ratepayer harm resulting from the termination agreement.

9 There are no other cogenerators in the vicinity that could provide the steam to the Port. (RT at 162.)

(estimated at approximately $4 per thousand pounds) is substantially higher than current contract price between Harbor and the Port (50 to 70 cents per thousand pounds). This suggests to us that the potential for successful negotiations is, in fact, quite favorable. (Exh. 20; RT at 227-228, 295-297, 299-300, 321.) In view of this evidence, we find SoCal's worst case assumption of zero steam sales to be unreasonable.

In addition, SoCal's analysis assumes that Harbor will never be able to generate income from ancillary services, such as voltage control, ramping and volt-ampere reactive power support. We agree with Edison and Indeck that this is another unrealistic assumption, given the favorable Harbor facility location in Edison's load center and the emergence of a market for such services. (Exh. 1, p. 7; Exh. 18.)

In further support of its assertions that Harbor will stop operating, SoCal argues that Harbor's net income without the contract will be negative. However, SoCal again uses a single snapshot in time to assess the future. SoCal's analysis assumes that (1) Harbor's net income will not be higher in the future than in 1996 and that (2) Harbor will not be able to sell power services at higher than Edison's 1996 average avoided costs. (RT at 340.) In addition to ignoring the potential for sales of ancillary services into the power exchange market or renegotiated steam sales, as discussed above, SoCal's analysis does not take into consideration the impact of future changes in debt servicing and of the termination payments on Harbor's financial picture. We recognize that information on Harbor's debt service obligations and the specific level and timing of termination payments was not part of the public record. However, SoCal's failure to acknowledge the potential impact of these factors on its analysis, even on a qualitative basis, undermines the credibility of its testimony. Our consideration of this information leads us to conclude that Harbor is likely to have positive net income in the future, even without the ISO4 contract.

Moreover, SoCal's presumption that Harbor will shut down for good and discontinue all use of gas upon termination of the contract is contradicted by declarations made by Harbor on the record. At the request of the assigned ALJ, John Salyer, President and Chief Operating Officer of Indeck was called to testify regarding this issue. He testified that Harbor did not have any plans to shut down the project when the contract was terminated. He stated that he believed that current negotiations would lead to positive power and steam sales in the future and that Harbor would be economic after termination of the current ISO4:

> A "This particular plant is in the largest load center for Southern California Edison's territory. It has a tremendous number of opportunities on a commercial and on a direct PX-sale basis. The facility is state of the art. We have looked into also doing upgrades to the facility and feel that based on this particular facility as it relates to other generating capacity in the general vicinity that it will be competitive.
>
> Q "And as you're looking at options in your business, is Harbor considering as one of its options shutting down the plant?
>
> A "No."[10]

In sum, we do not find SoCal's presumption that Harbor will shut down if we approve the termination agreement to be credible.

Even if SoCal made a convincing case in this proceeding that Harbor would shut down, SoCal's calculation of the resulting ratepayer harm ($39 million in NPV) is grossly inflated. In particular, SoCal uses the year 2019 as the end date for calculating the financial impact on its customers, the year the

[10] RT at 250-251; see also RT at 239-240.

contract between SCE and Harbor would have ended but for the termination agreement. However, the end date of the LTK is September 2003. For the reasons discussed above, we do not agree with SoCal that it had a reasonable expectation to continue to provide Harbor with transportation services throughout the term of the ISO4. Nor do we concur with SoCal's assertion that Harbor will have no other option but to obtain gas transportation services from SoCal after 2003. This assertion is unreasonable in light of the rapid and ongoing gas industry restructuring, including the Commission's consideration of gas transmission divestiture.[11] Even if gas industry restructuring does not result in divestiture of gas transmission, the record indicates that Harbor could also have gas transported by the City of Long Beach or other nearby industries once the LTK ends. (RT at 181-184.)

When adjusted for the proper end date, SoCal's calculations of ratepayer harm decrease from $39 million to approximately $18 million (NPV, 5.22% discount rate), the transport-or-pay value of the LTK and expected tariff revenues from October 1998 through September 2003. However, in making this calculation, SoCal uses the maximum LTK escalation rate, rather than an average of high and low rates, and uses projections of gas usage based on quantities higher than the annual contract quantity. (Exh. 1 pp. 10-11; Exh. 3, Attachment 1.) When adjusted further to correct these assumptions, and to reflect at 10% discount rate, the maximum gas ratepayer impact decreases to approximately $11 million.[12] This potential exposure assumes another worse case assumption on

[11] See Order Instituting Rulemaking, R.98-01-011, Attachment C.

12 These calculations were presented in Edison's Opening Brief, p. 31 and Chart 2, based on the adjustments recommended in Exhibit 1. We note that SoCal's calculation of ratepayer harm uses a significantly lower discount rate (5.22%) than the 10% cost of capital rate used by Edison in calculating electric ratepayer benefits. SoCal's Witness

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SoCal's part, namely, that Harbor will not have sufficient assets to pay the $3 million due under Section 5.4 of the LTK, should it cease operations. We find this assumption also to be unrealistic, especially in view of the fact that the termination payments to Harbor will be well in excess of this amount. (RT at 69-70; Exh. 4.)

In view of the above, we find that public necessity does not require Commission intervention on behalf of gas ratepayers in this case. While gas ratepayers could lose on the order of $8 million in LTK payments if Harbor ceases to operate under worse case assumptions, we believe that this is a very unlikely scenario. The evidence in this case indicates that it is much more likely that Harbor will continue to operate over the remaining term of the LTK; and that gas ratepayers will continue to benefit from the over-market payments received under the contract since 1993.[13] Moreover, even under worse case assumptions, the termination agreement produces more ratepayer benefit than harm.

Edison's application, as modified by Edison's withdrawal of its request for entitlement to a shareholder incentive payment, has met our criteria for approval

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Pope testified that it is valid to use two different discount rates to reflect differing risk structures facing the two utilities. SoCal's use of a lower discount rate reflects its view that SoCal faces less risks. (RT at 306-307.) However, in this proceeding, SoCal claims that its contract, the LTK, is dependent upon Edison's contract. (Ibid.) It therefore seems unreasonable to us to attribute a lower risk to SoCal's contract than to Edison's contract. Moreover, for comparison purposes, we traditionally use the same discount rate when comparing streams of future costs and benefits. Therefore, we base our calculations of NPV on a 10% discount rate.

[13] This amount has been estimated at approximately $5 million in NPV. See Late-Filed Exh. 22; Edison's Reply Brief Attachment 1; RT at 398; Edison's July 17, 1998 letter to the ALJ; SoCal's July 23 1998 letter in response and Edison's July 30, 1998 letter, in further response.

of QF contract buyouts and is hereby approved. Today's approval for rate recovery of termination payments is subject only to Edison's prudent administration of the termination agreement and the rate freeze provisions of Public Utilities (PU) Code §§ 330 et al.

On September 10, 1998, Edison and Harbor signed a Letter Agreement to amend the termination agreement to (1) extend the date by which the Proposed Decision must become final and no longer subject to appeal; and (2) provide that if Proposition 9 is adopted by the California electorate as a result of the November 3, 1998 election, the agreement shall terminate unless Edison waives this condition in writing. These amendments do not change the amounts to be paid to Harbor or the estimated amount of ratepayer savings resulting from the agreement. Edison served copies of the amendments on all parties to the proceeding, and no parties had any response to these amendments. Accordingly, we approve the amendments as part of our overall approval of Edison's application, subject to the modification noted above.

Findings of Fact

1. The Harbor Cogeneration Project is technically and economically viable.

2. The termination agreement is expected to yield net savings to Edison's customers in the range of $27.4 million, and, therefore, will result in substantial ratepayer benefit.

3. There is no basis for SoCal's assumption that PURPA or Commission policy afforded it a reasonable expectation of transporting gas to Harbor throughout the term of the ISO4 contract between Harbor and Edison.

4. Section 5.4 of the LTK directly addresses the risk of ratepayer harm that SoCal identified in this proceeding, namely, that Harbor could become uneconomic before the end of the contract term and cease operations.

5. Public necessity does not require Commission intervention to modify the liquidated damages provisions of the LTK on behalf of gas ratepayers in this case.

6. SoCal 's assertions that its ratepayers will be greatly harmed by the termination agreement are not supported by the record. SoCal's analysis is based only on a worst-case scenario, i.e., one that assumes that Harbor will cease operations upon approval of the termination agreement. This worst-case scenario is based on assumptions that are not credible and are contradicted by other information on the record. Even if the worst-case were likely to occur, SoCal's calculation of the resulting ratepayer harm is greatly inflated.

7. The termination agreement produces more ratepayer benefit than harm, even under worse case assumptions.

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

9. In this proceeding, Edison's recovery of termination payments is subject to the rate freeze provisions of PU Code §§ 330 et al.

10. The September 10, 1998 amendments to the termination agreement do not change the amounts to be paid to Harbor or the estimated amount of ratepayer savings resulting from the agreement.

Conclusions of Law

1. The termination agreement, as amended on September 10, 1998 should be approved as reasonable.

2. Edison should not be required to compensate SoCal for alleged harm to gas ratepayers, as requested by SoCal in this case.

3. 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 agreement. Rate recovery should also be subject to the rate freeze provisions of PU Code §§ 330 et al.

4. The application, as modified by Edison's withdrawal of its request for entitlement to a shareholder incentive payment, should be granted.

5. SoCal's late filing of comments at the Commission's Docket Office did not disadvantage any party, since those comments were served on all parties on the date that the comments were due. Therefore, SoCal's motion for leave to accept its late-filed comments should be approved.

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

ORDER

IT IS ORDERED that:

1. The December 23, 1997 application of Southern California Edison Company (Edison) for approval of the contract termination between Edison and Harbor Cogeneration Company, as modified by Edison's May 8, 1998 Withdrawal of Request For Finding Re Savings, is approved.

2. The Termination Agreement as set forth in Exhibit SCE-2 of the application, and as amended on September 10, 1998, is 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, 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 and the rate freeze provisions of Public Utilities Code §§ 330 et al.

4. The Motion of Southern California Gas Company For Leave To File Late Comments on Proposed Decision, dated September 9, 1998, is granted.

5. This proceeding is closed.

This order is effective today.

Dated September 17, 1998, at San Francisco, California.

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

APPENDIX A

************ SERVICE LIST ************

Last updated on 13-AUG-1998 by: LPD
A9712043 LIST

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(END OF APPENDIX A)