COM/RB1/JLN/rmn

Mailed 12/21/98

Decision 98-12-072 December 17, 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 Order Approving the Settlement Agreements Between Southern California Edison and Winning Bidders in Edison's Biennial Resource Plan Update Auction.	Application 97-05-027 (Filed May 13, 1997)

OPINION OF SOUTHERN CALIFORNIA EDISON COMPANY'S REQUEST FOR APPROVAL OF BIENNIAL RESOURCE PLAN SETTLEMENTS

1. Summary

This decision addresses the application of Southern California Edison Company (Edison) requesting that the Commission approve as reasonable the package of settlements it has achieved with certain bidders in the Biennial Resource Plan Update (Update) auction. The cost of the total settlement package is $92,142,163 (1997 net present value (NPV)). Based on the record, we find that the settlement package is reasonable. Therefore, we approve this application.

2. Background

2.1. The Update

In this application, Edison requests approval of a $92.142 million (1997 NPV) settlement package containing 10 settlements it has reached with certain bidders in Edison's Update auction.

In order to place this application in context, we set forth a brief summary of the Update. On July 7, 1989, the Commission issued Order

Instituting Investigation 89-07-004, which officially established the Update proceeding as the forum for addressing issues related to long-run avoided cost and resource planning and acquisition. The Commission issued various interim opinions which (1) adopted the terms of the Final Standard Offer 4 (FSO4) contract; (2) valued the environmental factors to be accounted for in evaluating new resource additions; and (3) determined the portion of cost-effective resource additions to be competitively solicited from a class of nonutility energy producers called qualifying facilities (QFs).[1]

On August 11, 1993, Edison commenced its solicitation in the Update in compliance with our orders. On December 9, 1993, Edison suspended the solicitation, informed the Commission of unanticipated bidding strategies, and reargued the wisdom of a number of policy implementation methods we had previously determined (e.g., second price auction, renewable set-aside). In June 1994, we issued Decision (D.) 94-06-047, which modified portions of the FSO4 to address unanticipated bidding strategies and recommenced the solicitation schedule. The Commission later stayed D.94-06-047 on its own motion in D.94-10-039.

A number of parties filed applications for rehearing. These pleadings culminated in D.94-12-051, which denied, *inter alia*, an application by Edison for rehearing of D.94-06-047, but granted a limited rehearing at the request of Flowind Corporation in order to review and determine the as-available wind bidders. The Commission also lifted the stay it issued in D.94-10-039, and required Edison to negotiate additional terms and to submit FSO4 contracts to

[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.

the Commission for approval by advice letter filing. Edison did not submit any executed FSO4 contracts, but submitted proposed settlements with five bidders whom Edison had designated as "winning bidders" pursuant to procedures delineated in various Update decisions.

Following the Commission's issuance of D.94-12-051, Edison and San Diego Gas & Electric Company (SDG&E) filed petitions for enforcement with the Federal Energy Regulatory Commission (FERC) challenging the Commission's reinstatement of the solicitation, and seeking to enjoin the implementation of our orders and to be relieved from having to enter into contracts with the bidders designated as "winning bidders."

On February 23, 1995, FERC issued an *Order on Petitions for Enforcement Action Pursuant to Section 210(h) of PURPA* in Docket Nos. EL95-16-000 and EL95-19-000 (February 23 FERC Order).[2] FERC ruled that this Commission's implementation of the Update violated PURPA and FERC's implementing regulations because this Commission did not consider all sources of electric capacity in setting avoided cost prices. The FERC concluded:

> "Because the California Commission's procedure was unlawful under PURPA, Edison and San Diego cannot lawfully be compelled to enter into contracts resulting from that procedure. At this juncture, there are no executed contracts. However, in order to avoid parties spending further time and resources in pursuing contracts that would be unlawful under PURPA, we believe it would be

[2] PURPA is the Public Utility Regulatory Policies Act of 1978. The utilities filed their petition for enforcement pursuant to Section 210 of PURPA, 16 U.S.C. § 824a-3(h) (1988).

> appropriate for the California Commission to stay its requirements directing Edison and San Diego to purchase pending the outcome of further administrative procedures in accordance with PURPA. We also encourage the utilities and QFs to reach a settlement that would be consistent with PURPA." (February 23 FERC Order, slip op. at pp. 26-27.)

The February 23 FERC Order precipitated the filing of various motions to stay the Update. On March 7, 1995, the Assigned Commissioner issued an interim stay of the Update auction and called for comments on four alternative actions that the Commission might take. On March 16, 1995, the full Commission, on its own motion, extended the interim stay in D.95-03-019, 59 CPUC2d 52. We issued this interim stay "in order to permit additional time to assess the impact of the FERC order on the Update proceeding and to review the Commission's legal and policy options. A stay will also suspend the deadlines for the signing of contracts by the utilities and will avoid what may be the needless expenditure of time and resources by the parties and the Commission in order to resolve the rehearing issues in this proceeding." (59 CPUC2d at 53.)

The Commission and numerous parties filed requests for rehearing or clarification of the February 23 FERC Order. FERC issued a notice stating its intent to treat these requests for rehearing as motions for reconsideration. FERC issued its *Order on Requests for Reconsideration* on June 2, 1995. In that order, FERC upheld the February 23 FERC Order.

On July 5, 1995, the Assigned Commissioner issued a ruling (July ACR) which is discussed more fully below. The July ACR memorialized the public discussion among Commissioners at the June 21, 1995 meeting, and stated that the Commission was unanimous in finding settlement the most appropriate next step in the Update proceeding, as long as ratepayer interests were advanced

and protected by the settlements. (July ACR, slip op. at p. 7.)[3] The July ACR set forth criteria by which the Commission would evaluate settlements with bidders, and directed each utility to file a single application containing all the settlement agreements it wishes the Commission to approve. (*Id.* at p. 11.)

2.2. This Application

On May 9, 1997, Edison filed this application seeking approval of a settlement package containing 10 settlements it has reached with bidders Edison designated as "winning bidders," subject to the outcome of certain judicial and regulatory proceedings challenging the legality of the Update. The total amount of the settlements is $92.142 million (1997 NPV). Edison's filing included SCE-1, copies of the settlement agreements; SCE-2, the prepared testimony of Janet Pasker, setting forth an overview of the settlement process and why Edison believes the package as a whole is reasonable and should be approved; and SCE-3, the prepared testimony of Dr. Richard B. Davis and David Schiada, setting forth Edison's detailed analysis of customer benefits.[4]

---

[3] In a clear exercise of authority conferred by Article 12, Section 2 of the California Constitution, the Commission voted unanimously at the June 21, 1995 meeting to delegate to the Assigned Commissioner the task of memorializing their public discussion so that it might provide guidance to the settling parties. (July ACR, slip op. at p. 1-2.) First enacted by the people in 1879, that portion of the Constitution provides that: "... Any commissioner as designated by the commission may hold a hearing or investigation or issue an order subject to commission approval."

[4] Some of the dates set forth in the settlement agreements in SCE-1 have expired on their own terms. However, in pleadings, parties have stated or implied that these dates have been extended so that the settlements would be effective upon the Commission's approval thereof. We address this application under the assumption that all relevant dates in the settlement have been extended so that the settlement agreements will become effective upon the Commission's approval thereof. If this assumption is incorrect, we do not approve the settlement package.

Edison also filed a motion for protective order with its application, seeking to protect portions of its application and prepared testimony. The Office of Ratepayer Advocates (ORA) filed a protest to Edison's application, as well as an opposition to Edison's motion for protective order. Two losing wind bidders, CalWind Resources, Incorporated (CalWind) and Windland Incorporated (Windland) jointly filed a protest. Cal Wind/Windland, together with Flowind Corporation, jointly filed an opposition to Edison's motion for protective order. Geo-Energy Partners-1983 Ltd. (Geo), which did not bid in the Update auction, also filed an opposition to Edison's motion for protective order. Various bidders with whom Edison settled filed responses or replies to the protests, or oppositions to the protective orders.

Mammoth Power Associates, LP (Mammoth), a bidder which settled with Edison, also filed a motion for protective order with respect to Mammoth's financial results and projections which are contained in the application. Geo responded to this motion.

On February 17, 1998, Edison and ORA filed a joint motion seeking Commission approval of a stipulation pursuant to which: (1) Edison would disclose additional portions of the settlement agreements, but still would omit reference to the amount of the individual settlement payment agreed to by the settling parties; (2) Edison would disclose the aggregate amount of the settlement payments; (3) Edison would provide a nonpublic version of the application and exhibits to The Utility Reform Network (TURN), which could protest the application within 30 days of receipt of the nonpublic version; and (4) ORA would withdraw its opposition to Edison's motion for protective order. CalWind/Windland and Geo opposed this motion. TURN subsequently filed a protest to the application, to which Edison, SDG&E, and certain settling bidders replied.

On March 27, the Assigned Commissioner and Administrative Law Judge (ALJ) held a prehearing conference. A May 28 Joint Assigned Commissioner and ALJ ruling (May 28 Ruling) granted Edison's protective order motion as amended by the stipulation as more fully set forth in the May 28 Ruling. The ruling also determined that hearings were not necessary, but called for further briefing. The May 28 Ruling determined that this proceeding is not subject to the rules implementing the recently enacted Senate Bill 960, since the application was filed in 1997 and no hearings are necessary. We affirm the May 28 Ruling in all respects.

The May 28 Ruling called for briefing on the following issues:

"1. Are the settlements included in the application, when reviewed as a package, reasonable?

"2. What are the appropriate criteria to use to determine reasonableness?

"3. Assuming the Commission approves the settlements, what should be the source of the funds to pay for the settlements? In response to this question, parties should address, among other things, the interplay between various sections of the PU [Public Utilities] Code which relate to this issue including but not limited to:

a) PU Code § 367(a)(3), which states that costs associated with contracts approved by the Commission to settle issues associated with the Biennial Resource Plan Update may be collected through March 31, 2002; provided that only 80 percent of the balance of the costs remaining after December 31, 2001, shall be eligible for recovery;

b) PU Code § 381(c)(5), stating that up to $90 million of the amount collected pursuant to § 381(d) may be used to resolve outstanding issues related to the Update for Edison; and

c) PU Code § 381(d) which speaks to a $540 million payment for public purpose programs.

"4. Should the Commission grant all other relief requested by Edison's application? Why or why not?" (May 28 Ruling at pp. 12-13.)

The following parties filed opening or reply briefs: Edison; ORA; TURN; and various bidders with whom Edison has settled (settling bidders).[5] In addition, the following settling bidders also filed individual supplemental briefs: KENETECH Windpower, Inc., Oxbow, and Seawest.

CalWind and Windland also filed briefs and subsequently each made a motion to withdraw its protests and pleadings opposing the application. CalWind and Windland each state that they have settled with the bidders with whom Edison has settled, and as a result, now fully support Edison's application. CalWind and Windland also state that they have agreed that if the Commission issues an order approving the Edison application in its entirety and without modification, they will release all claims they may have against Edison, the settling bidders and SDG&E in this application, in SDG&E's application (A.) 97-10-081), and in the Update proceeding. CalWind and Windland do not request Commission approval of their settlements, nor do they provide the specific terms thereof. As a result of these filings, Zond moved to withdraw its supplemental pleading. We grant the separate motions of CalWind, Windland, and Zond to withdraw their respective pleadings.

---

[5] The following settling bidders filed a joint brief: Kelso Windpower Partners 1, L.P.; Bowerman Renewable Power Partners and Olinda Renewable Power Partners, L.P.; Zond Systems, Inc. (Zond); U.S. Generating Company; Oxbow Power Company (Oxbow); Seawest Energy Corporation and Toyo Power Corporation (Seawest); Magma Generating Company II; BTI Chino, Inc.; and Mammouth Power Associates, L.P.

2.3. *Parties' Positions*

2.3.1. Edison

Edison's settlement package reflects two approaches: options and bid withdrawal agreements. The option agreements give Edison the option to buy more than 393.6 megawatts (effective MW) of additional alternative and renewable resources pursuant to various terms, rates and conditions. The bid withdrawal agreements provide for the bidders to be paid sums in lieu of 292.8 MW of Update contracts. The total cost of the settlements is $92,142,163.00 (1997 NPV).

Edison states that customer benefits total $1.169 billion (1997 NPV), when the settlements are compared with the costs ratepayers would have had to pay if the FSO4 contracts were entered into and fulfilled for their whole term. Edison estimates that the FSO4 costs, net of replacement power, and including transmission are $1,261 billion.[6]

The settlement approaches, as allocated among Edison's 10 winning bidders, are reflected in Table 1. Table 2 summarizes what Edison states are the ratepayer benefits provided by the settlement according to Edison's median case. (The settlement amount for each bidder is not disclosed in this decision, since that specific information is under a protective order.)

[6] Edison states that its economic analysis of the settlement is based on its replacement price forecast in place during the time the settlements were being negotiated. In March 1997, Edison adopted a new replacement price forecast, and states that the customer savings under the settlements are slightly greater under the March 1997 forecast.

TABLE 1 - SETTLEMENT APPROACH BY BIDDER

BIDDER	UPDATE CAPACITY (EFFECTIVE MW)	SETTLEMENT TYPE
BOWERMAN/OLINDA	14.594	BID WITHDRAWAL
BTI CHINO	3	BID WITHDRAWAL
KENETECH	99	BID WITHDRAWAL
MAGMA	68.886	BID WITHDRAWAL
MAMMOTH POWER	21.78	BID WITHDRAWAL
OXBOW	22	OPTION
ROSEBUD	2	BID WITHDRAWAL
SEAWEST	60.4	BID WITHDRAWAL
U.S. GEN	371.6	OPTION
ZOND	23.14	BID WITHDRAWAL
TOTAL	686.4	

TABLE 2 - EDISON'S SUMMARY OF UPDATE SETTLEMENT BENEFITS

FSO4 COSTS INCLUDING TRANSMISSION (NET OF REPLACEMENT POWER)	EDISON'S PROPOSED SETTLEMENT PAYMENTS	EDISON'S STATED CUSTOMER BENEFITS
$1,261,512,310 (total, 1997 NPV)	$92,142,163 (total, 1997 NPV)	$1,169,370,147 (total, 1997 NPV)

Edison believes that the settlements, as a package, are reasonable and that this Commission should approve them. In reliance on criteria this Commission set forth in *Re Pacific Gas and Electric Company*, D.88-12-083, 30 CPUC2d 189 (*Diablo Canyon*), Edison believes that a settlement's reasonableness can be determined by the relationship of the amount agreed upon to the risk of obtaining the desired result. Edison believes *Diablo Canyon* precludes a strict probability analysis of the chance of each party prevailing in order to determine risk. Rather, Edison believes that the Commission should ascertain whether the total settlement amounts adequately account for the relative strengths of the parties' cases. Edison believes that the correct perspective from which the Commission should evaluate the settlements is whether the package is reasonable in light of the risks known to the parties at the time the settlements were entered into, and not as they presently exist.

Edison also states that, in settlement negotiations, it took into account the effect of the enactment of Assembly Bill (AB) 1890. This led Edison to renegotiate three settlements in February and March 1997. After the enactment of AB 1890, Edison questioned whether it was reasonable to go through with the build-out settlements (the construction and operation of new QF renewable projects), which would have required Edison to purchase power under long-term fixed price power purchase contracts. Edison also states that the payments under the build-out settlements were expected to be above-market for a number of years beyond March 31, 2002, the date AB 1890 establishes as the cut-off for competition transition cost recovery related to the Update settlements. Some settlements also required QF production as early as December 1997, before the Commission might address this application. Therefore, Edison renegotiated these build-out settlements into bid withdrawal agreements. Edison states that

this renegotiation has resulted in $23.3 million (1997 NPV) in additional customer savings.

Edison believes that the $92 million aggregate settlement amount is consistent with an analysis of the measure of risk of an adverse result. Edison explains that because the settlements were negotiated over time, the resulting package fairly reflects the evolution of the Update proceeding from one in which the execution of FSO4 contracts appeared to be certain to one of far less certainty. Edison also believes that a settlement amount which represents less than 10% of the total exposure in this case appropriately reflects the diminishing likelihood over time of an adverse result for Edison and its ratepayers. Edison states that if it had held out for settlements based solely on reasonable bid preparation or reliance costs, that it would not have been able to achieve the settlement package.

Edison also believes that the settlement package is consistent with the July ACR because, if adopted, it will bring an immediate and permanent end to litigation flowing from the Update auction in any agency or court. Edison believes the two option contracts originally addressed the Commission's desire stated in the July ACR to see projects built and operated in furtherance of statutory resource procurement mandates.

2.3.2. The Settling Bidders

The settling bidders also believe the settlement package is reasonable and should be approved. These bidders believe that the settlement package avoids what they characterize as lengthy and contentious litigation for all parties. They also believe that the aggregate settlement amounts fall within a range of likely outcomes (between the settling bidders receiving nothing and their receiving 100% of their expectation interest in a FSO4 contract). They argue

that in that context, a settlement figure of about $92 million, which is less than 8 cents on the dollar, is reasonable.

They also believe the settlement meets the criteria of the July ACR because, in addition to eliminating litigation, the settlement package contains option provisions. Although the settling bidders state that it is currently unclear whether and in what circumstances Edison would wish to exercise that option, the fact that it exists provides Edison and its ratepayers valuable insurance to protect against future uncertainty in the generation market. These bidders do not believe that reliance costs should be the only criteria to determine the reasonableness of the buyouts, because many QFs would not have settled for reliance costs and, thus, Edison could not have obtained a settlement package to present to the Commission.

2.3.3. ORA

ORA strongly opposes the settlement package. ORA believes that the settlement amount is excessively high, and that Edison and the settling bidders have not described any scenario under which they could compel Edison to enter into FSO4 contracts. ORA believes that the July ACR limited buy-out settlements to reasonable bid preparation and reliance costs, and that Edison negotiated buyout settlements without making any effort on behalf of ratepayers to limit settlement payments to the reliance interests of the settling bidders. ORA also points out that Edison did not attempt to renegotiate the five settlements it entered into prior to the issuance of the July ACR.

ORA believes that in order for the Commission to determine the reasonableness of the settlement, it should consider the likelihood of the success of the litigation that would result in mandating Edison to enter into FSO4 contracts. According to ORA, only then can the Commission assess the settlement amount in relation to the parties' risk in obtaining the desired result.

ORA presents a legal analysis which it states demonstrates an extremely low likelihood of the settling bidders possessing contractual rights.

ORA also believes that the option component of the settlement package adds no value from the ratepayer's perspective given the status of electric industry restructuring. ORA states that in the Commission's Preferred Policy Decision, D.95-12-063, as modified by D.96-01-009, slip op. at p. 51, Edison is required to obtain its energy needs from the Power Exchange and to bid all the power Edison generates into the Exchange. According to ORA, the exercise of the option agreement would violate the Commission's policy mandate because Edison would purchase less energy from the Exchange, and could potentially compete in the direct access market with ratepayer-subsidized option contracts. ORA also states that Edison has not offered any testimony on the current value of the options.

ORA states that it attempted to analyze the settlement amounts in comparison to the bidders' reliance interest. However, Edison did not possess reliance cost information and the settling bidders did not quantify such costs because they believed the July ACR did not require such a settlement. Meanwhile, SDG&E filed A.97-10-081 which contained settlements with three settling bidders, two of whom (SeaWest and Magma) are also settling bidders in this Edison application. ORA states that it was able to obtain information regarding reasonable bid preparation and reliance costs for SDG&E bidders, as memorialized in the publicly released SDG&E settlement amounts of $5.095 million for 108 MW. As part of the compromise on the dispute regarding whether ORA could compel the settling bidders to provide reliance cost data for their Edison bids, ORA, Edison, and the settling bidders agreed to allow ORA to use the publicly released, aggregated SDG&E settlement amounts as evidence in this proceeding.

According to ORA's computations, SDG&E's settlements total about $47,000/MW for the capacity settled. ORA states that if Edison had settled its 686.39 MW of effective capacity at a similar level, the aggregate settlement amount would have been about $32.4 million instead of $92.1 million, saving about $60 million, and that SDG&E settled for about 35% of the amount of Edison. ORA observes that certain of the SDG&E settlements escalate according to certain market interest rates until the Commission approves them. ORA states that, even with the escalation, SDG&E settled at approximately 40% of the cost of Edison's settlements. Even though this comparison is not perfect, ORA believes it is an appropriate approximation, and could resolve the proceedings more quickly than arguing whether or not the settling bidders should provide their bid preparation and reliance cost information.

ORA also states that the SDG&E settlements are an appropriate range to represent fairly the range of the Edison settlements, since the SDG&E benchmark is derived from an aggregate of three settlements ranging from 1.25 MW to 94 MW, while the Edison settlements (with the exception of U.S. Generating Company which comprises 371 MW) range from 2 MW to 99 MW. ORA also believes that on a dollars/MW basis, settlements of a greater amount of MW should cost less than settlements of smaller amounts of capacity because there are similar fixed costs common to each bid.

2.3.4. TURN

TURN also strongly opposes the settlement and believes that the criteria to determine reasonableness of the settlements should be those set forth in the July ACR. TURN believes the Commission should reject the settlements because Edison has not demonstrated the settlements' reasonableness in light of the substantial risks that the bidders would not fully perform under the FSO4 contracts. TURN believes that implementing the auction is highly

unrealistic in view of the Commission's recent attempts to implement a competitive generation market, as well as the fact that a federal court would in all likelihood follow FERC's advisory opinion. TURN believes although the Commission has recognized that risk cannot and need not be quantified with precision to approve a settlement as reasonable in some cases, the prior Commission cases cited by Edison and the settling bidders addressed settlements where an advocate of ratepayer interests supported the settlement, which is not the case here. Thus, TURN believes that the appropriate criteria for determining the reasonableness of the settlements are reliance costs, as set forth in the July ACR.

3. Discussion

3.1. The July ACR

The July ACR memorialized the goals and objectives of the settlement process which the Commission unanimously encouraged at its June 21, 1995 meeting.

> "First, each settlement should eliminate litigation - in any agency or court - flowing from the auction. Additionally, the settlements each utility reaches with individual bidders, should, when considered as a package, (1) achieve the resource procurement statutory mandates, including mandates for diversity provided by renewable resources; (2) add capacity which lowers the operating cost of the system; (3) add capacity which meets reliability needs, if such a need has been identified." (July ACR, slip op. at pp. 7-8.)

The July ACR also memorialized a number of settlement options (without intending to make an exclusive list), such as "the option," "the buyout," and "the contract." (*Id.* at p. 8.) The July ACR recognized that FERC also encouraged the utilities and the QFs to achieve settlements consistent with

PURPA. However, it cautioned that that the Commission did not encourage settlements at all costs:

> "The surest way to achieve settlement would be to assure parties that any costs of settlement would be fully recovered from ratepayers so that QFs merely needed to tell utilities how large a check to write. We are decidedly not encouraging such settlement, nor are we preapproving recovery of settlement costs. Commissioner Conlon said it best during our public discussion: we want to see value received for payment given." (*Id.* at p. 9)

In the July ACR, we defined (1) "the option" as a settlement which forms a contract that provides the utility an option to have additional capacity built at a future time; (2) "the buyout" as a settlement which makes an otherwise winning bidder whole for reasonable bid preparation or reliance costs; and (3) "the contract" as an agreement between a winning bidder and the utility to sign an FSO4, or modified FSO4. (Id. at p.8.). The Assigned Commissioner elaborated that he would view with disfavor buyout contracts which pay QFs more than their bid preparation or reliance interest. "This means that I will not look with favor on buyout agreements which seek to go beyond the recoupment of a reliance interest to approximate an expectation interest. The reason is plain: in a buyout strategy ratepayers will not gain the advantage of capacity additions." (*Id.*)

As stated above, the July ACR memorialized the goals and objectives of the settlement process, and a number of settlement options which the Commission unanimously encouraged at its July 21, 1995 meeting. Thus, it carries more weight than an individual ACR expressing the views of only one member of the Commission.

3.2. *Reasonableness of the Settlements*

This application presents settlements which are not "all-party" settlements, because ORA and TURN strongly oppose them. Therefore, we review the settlements pursuant to Rule 51.1(e) of the Commission's Rules of Practice and Procedure which provides that, prior to approval, the Commission must find a settlement "reasonable in light of the whole record, consistent with the law, and in the public interest."

Based on this record, we find that the settlement package is reasonable and is in the public interest, and therefore approve it.

Edison and the settling bidders argue that the settlement package is reasonable because it meets the criteria this Commission enunciated in *Diablo Canyon* and because Edison entered into many of the settlements before the FERC ruling when the probability of the Commission going forward with the Update proceeding was greater. ORA and TURN also reference the *Diablo Canyon* criteria, but believe that the application has not satisfied these criteria, and believe that the settlements' reasonableness should be determined at the time of the issuance of the July ACR.

In *Diablo Canyon*, the Commission analogized the settlement principles applicable in class actions, because *Diablo Canyon* involved the settlement of numerous claims of similarly situated protestants, and all of PG&E's customers. This case also involves the settlement of numerous claims of similarly situated bidders, and Edison's ratepayers.

In *Diablo Canyon*, we stated that the standard used by the courts in their review of proposed class action settlements is whether the class action settlement is fundamentally fair, adequate, and reasonable. (30 CPUC2d at 222.) We thereafter quoted with approval Proposed Rule 51.1(e) of our Rules of Practice and Procedure, which is now a final rule. As stated above, Rule 51.1(e)

provides that this Commission will not approve a settlement unless the "settlement is reasonable in light of the whole record, consistent with the law, and in the public interest."

We then set forth various factors a court would use to determine reasonableness.

> "In order to determine whether the settlement is fair, adequate, and reasonable, the court will balance various factors which may include some or all of the following: the strength of the applicant's case; the risk, expense, complexity, and likely duration of further litigation; the amount offered in settlement; the extent to which discovery has been completed so that the opposing parties can gauge the strength and weakness of all parties; the stage of the proceedings; the experience and views of counsel; the presence of a governmental participant; and the reaction of the class members to the proposed settlement." (*Id.*)

We also stated that the "most important element in determining the fairness of a settlement is the relationship of the amount agreed upon to the risk of obtaining the desired result." (30 CPUC2d at p. 267.) However, we cautioned that risk is not measured by the amount in controversy, but by the relative strengths of each party's case.

> "...Although the amount in controversy, $4.4 billion, is great, that in itself does not measure the risk. The measure is the relative strength of each party's case.
>
> "Risk, in the context of a settlement approval, need not be measured with precision, nor can it, without an opportunity to see and hear witnesses and cross-examine them in the underlying action. But if risk cannot be measured precisely in this instance, still it must be measured. To that end, we believe it sufficient to analyze the risks involved in going to trial on the two major issues of this case: the Hosgri Fault discovery and the mirror image error." (*Id.*)

Because the individual settlements were entered into over time, it is necessary to determine from what timeframe we conduct our assessment of the settlement package's reasonableness. ORA urges that we assess reasonableness at the time the July ACR issued and not before. However, Edison reached settlements with most of the settling bidders prior to the July ACR's issuance. We therefore believe it is appropriate to assess the reasonableness of the settlement package based on the facts Edison knew or should have known at the time it entered into the settlements. This is consistent with the approach the Commission has taken in reviewing a utility's actions for reasonableness. (*See e.g.*, D.88-10-032, 29 CPUC2d 415, 428.)

Diablo Canyon recognizes that some factors the court will balance when assessing the settlements' reasonableness include the expense, complexity, and likely duration of further litigation. If Edison and some of the settling bidders did not initiate settlement discussions in late 1994, and execute the settlement agreements shortly thereafter, further litigation in federal and state court at that time and immediately following FERC's February 23 Order could have been expensive, complex, and lengthy. Thus, this settlement package reduced this possibility for all parties which could have been involved in such potential litigation.

In addressing *Diablo Canyon's* "most important" element in determining the fairness of a settlement – the relationship of the amount agreed upon to the risk of obtaining the desired result – we believe that this settlement package is reasonable in light of the risks known to the parties at the time the settlements were entered into, and not necessarily as the risks presently exist. For example, Edison began its negotiations with some of the settling bidders prior to the issuance of FERC's February 23 Order, when the probability of the Commission going forward with the Update was greater. Even after the issuance

of the February 23 FERC Order, the Commission itself filed a request for rehearing, and it was not until June 2, 1995 that FERC denied all such requests. Approximately one month later, in July 1995, the Assigned Commissioner issued the July ACR encouraging settlement as the most appropriate next step. Because the settlements were negotiated over time, the resulting settlement package fairly reflects the evolution of the Update proceeding from one in which the Commission going forward with the Update was certain to one of much less certainty.

We also note that the settlement package represents less than 10% of the total possible exposure to Edison in this case assuming a worst case scenario. This figure is reasonable based on an assessment of risk over the continuum discussed above, as opposed to an assessment of risk today.

The July ACR memorialized the goals and objectives of the settlement process, and a number of settlement options which the Commission unanimously encouraged at its June 21, 1995 meeting. Thus, it carries more weight than an individual ACR expressing the views of only one member of the Commission.

The July ACR recognized the value to ratepayers in a package of settlements that will eliminate the potential for any litigation flowing from the Update proceeding. The fact that the settlement package reduces litigation does not itself require the conclusion that the amounts are reasonable. However, we discuss the reasonableness of the amount of the settlement package above, based on the time when each settlement was entered into.

The July ACR defined the settlement outcome of a "buyout" as "a settlement which makes an otherwise winning bidder whole for reasonable bid preparation costs or reliance costs." (July ACR at p. 8.) The Assigned

Commissioner elaborated in footnote 4 on page 9 that he would personally view with disfavor buyout contracts which pay QFs more than their bid preparation or reliance interest and approximate an expectation interest. ORA argues that because of this portion of the July ACR, no settlement which contains a "buyout" based on any factors other than bid preparation or reliance costs is reasonable.

While we do not address here ORA's position with respect to settlement packages which were negotiated entirely after the July ACR was issued, we do not believe that it is appropriate to so limit Edison's settlement package because of the time during which some of the settlements were negotiated. At the time of the July ACR's issuance, the Commission was aware that Edison had settled with some bidders with buyout agreements. (See July ACR at p. 7.) The Commission did not address those agreements, but rather, encouraged settlement as the most appropriate next step. Because the Commission did not specifically disapprove the agreements at that time, it is reasonable that Edison proceeded to attempt to settle with the remaining bidders, and when it obtained the full package of settlements, to present them to the Commission for approval.

We caution that because of the unique facts of this case, this decision should not be used as precedent with respect to the reasonableness of other settlements. This is particularly the case with respect to the settlements which SDG&E presents to us in A.97-10-081, or any future settlements which may be presented to us between certain bidders and SDG&E or Pacific Gas and Electric Company with respect to their Update solicitations. Because SDG&E's settlements were all executed after the February 23 FERC Order and the July ACR, it is reasonable to assess those settlement's reasonableness from a different timeframe. Moreover, in SDG&E's case, as well as with respect to other potential settlements, it may be reasonable to limit the permissible types of "buyout"

agreements the Commission finds reasonable to those specifically set forth in the July ACR, as further elaborated in footnote 4, since all potential settling parties were clearly on notice of this definition, and no agreement in the settlement package presented to the Commission had been negotiated before the issuance of the July ACR.

We therefore: (1) find the settlement package as a whole to be reasonable and Edison's entering into these settlement agreements prudent; (2) authorize full recovery, through Edison's Transition Cost Balancing Account (TCBA), of payments made by Edison under these settlement agreements, and pursuant to any power purchase agreement entered into pursuant to the option settlements, subject to Edison's prudent administration of the settlement agreements and any power purchase agreement resulting from the prudent exercise of an option; and (3) find these agreements replace all effective megawatts in Edison's Update solicitation, and that these agreements shall be in lieu of the Update capacity that would have otherwise have been awarded to bidders pursuant to Edison's Update solicitation. In light of this determination, the limited rehearing ordered in D.94-12-051 should be cancelled with respect to Edison and all effective megawatts in Edison's Update solicitation.

3.3. Source of Funds for Settlement

The May 28 ruling also requested that the parties brief the issue of what is the correct source of funds to pay for the settlements, and the interplay between PU Code § 367 and § 381.

Section 367(a)(3) provides that costs "associated with contracts approved by the commission to settle issues associated with the Biennial Resource Plan Update may be collected through March 31, 2002; provided that only 80 percent of the balance of the costs remaining after December 31, 2001, shall be eligible for recovery."

This means that the Legislature has clearly delineated that costs associated with a Commission-approved settlement of the Update are uneconomic costs as set forth in PU Code § 367, and are eligible for recovery as transition costs as more specifically set forth in § 367.

We do not agree with TURN that the Commission, in determining the correct source of the funds to pay for Edison Update settlements, is presented with a choice between PU Code § 367 and § 381. Rather, with respect to costs associated with Commission-approved Edison Update settlements, § 381 describes the mechanism whereby 80% of such costs which remain outstanding as of December 31, 2001, are to be recovered during the three-month period set forth in § 367(a)(3).

PU Code § 381(d) provides:

> "Notwithstanding any other provisions of this chapter, entities subject to the jurisdiction of the Public Utilities Commission shall extend the period for competition transition charge collection up to three months beyond its otherwise applicable termination of December 31, 2001, so as to ensure that the aggregate portion of the research, environmental, and low-income funds allocated to renewable resources shall equal five hundred forty million dollars ($540,000,000) and that the costs specified in paragraphs (3), (4), and (5) of subdivision (c) are collected."

PU Code § 381(c)(5) provides:

> "Up to ninety million dollars ($90,000,000) of the amount collected pursuant to subdivision (d) may be used to resolve outstanding issues related to contractual arrangements in the Southern California Edison service territory stemming from the Biennial Resource Plan Update auction. Moneys remaining after fully funding the provisions of this paragraph shall be reallocated for purposes of paragraph (3)."

Thus, read together, § 367(a)(3) and § 381(c)(5) and (d) provide that 100% of Edison's Commission-approved Update settlement costs are eligible for

transition cost recovery through December 31, 2001, after which 80% of the outstanding balance (if any exists) - up to a total of $90 million - is recoverable through March 31, 2002 from funds collected pursuant to § 381(d).

ORA points out that the priorities established in § 381(c)(3), (4), and (5) could result in Commission-approved Update settlements being fully funded and the $75 million dedicated to renewables not being funded or not being fully funded during the period between December 31, 2001 and March 2002. ORA suggests that this result might be incompatible with the legislative intent favoring funding of renewables. Edison disagrees with ORA's argument, but agrees that § 381(c)(3), (4), and (5) set up a priority under which Edison's Commission-approved Update settlements would be fully funded before the additional $75 million is allocated to renewables. The settling bidders believe that any recovery of these Update settlement costs during the three-month extension period should not affect the full $75 million funding level for renewables.

We agree with Edison that this priority is expressly set out in § 381, thus indicating the Legislature's preference that the Edison Update settlements be funded before the additional $75 million is allocated to renewables. (i.e., "Moneys remaining after fully funding the provisions of this paragraph [which addresses settlements concerning Edison's Update auction] shall be reallocated for the purposes of paragraph (3)." (PU Code § 381(c)(5).)

4. Comments to the Draft Decision and Alternate

Although not required by Public Utilities Code § 311(d), the draft decision of ALJ Econome and Alternate Pages of Assigned Commissioner Conlon were mailed to the parties for comments on November 18, 1998, since it was determined that comments within the scope of Rule 77.3 may serve the public interest in this case.

The following parties filed comments: Edison, ORA, the Independent Energy Producers Association, TURN, and the settling bidders (jointly).

This alternate decision differs from the draft decision and alternate pages in that it approves the application without imposing further conditions or modifications to the settlement agreements.

Findings of Fact

1. In this application, Edison requests approval of a $92.142 million (1997 NPV) settlement package containing 10 settlements it has reached with certain bidders in Edison's Update auction.

2. Edison's settlement package reflects two approaches: options and bid withdrawal agreements. The option agreements give Edison the option to buy more than 393.6 megawatts (effective MW) of additional alternative and renewable resources pursuant to various terms, rates and conditions. The bid withdrawal agreements provide for the bidders to be paid sums in lieu of 292.8 MW of Update contracts. The total cost of the settlements is $92,142,163.00 (1997 NPV). Edison states that customer benefits total $1.169 billion (1997 NPV), when the settlements are compared with the costs ratepayers would have had to pay if the FSO4 contracts were entered into and fulfilled for their whole terms.

3. The July ACR memorialized the goals and objectives of the settlement process, and a number of settlement options which the Commission unanimously encouraged at its July 21, 1995 meeting. Thus, it carries more weight than an individual ACR expressing the views of only one member of the Commission.

4. We assess the reasonableness of the settlement package based on the facts Edison knew or should have known at the time it entered into the settlements.

5. If Edison and some of the settling bidders did not initiate settlement discussions in late 1994, and execute the settlement agreements shortly thereafter, further litigation in federal and state court at that time and immediately

following FERC's February 23 Order could have been expensive, complex, and lengthy. This settlement package reduced this possibility for all parties which could have been involved in such potential litigation.

6. In assessing the relationship of the amount agreed upon to the risk of obtaining the desired result, we believe that this settlement package is reasonable in light of the risks known to the parties at the time the settlements were entered into.

7. The July ACR recognized the value to ratepayers in a package of settlements that will eliminate the potential for any litigation flowing from the Update proceeding.

8. While we do not address ORA's position that the July ACR limited a "buyout" to a bidder's bid preparation or reliance costs with respect to settlement packages which were negotiated entirely after the July ACR issued, we do not believe that it is appropriate to so limit Edison's settlement package because of the time during whi ch some of the settlements were negotiated.

9. We caution that because of the unique facts of this case, this decision should not be used as precedent with respect to the reasonableness of other settlements. This is particularly the case with respect to the settlements which SDG&E presents to us in A.97-10-081, or any future settlements which may be presented to us between certain bidders and SDG&E or Pacific Gas and Electric Company with respect to their Update solicitations.

10. It is time to conclude issues dealing with Edison's Update solicitations.

Conclusions of Law

1. The May 28 Ruling should be affirmed in all respects.

2. The separate motions of CalWind Resources, Incorporated, Windland Incorporated, and Zond Systems, Inc., to withdraw their respective pleadings should be granted.

3. We: (1) find the settlement package as a whole is reasonable and in the public interest, and Edison's entering into these settlement agreements prudent; (2) authorize full recovery, through Edison's TCBA of payments made by Edison under these settlement agreements, and pursuant to any power purchase agreement entered into pursuant to the option settlements, subject to Edison's prudent administration of the settlement agreements and any power purchase agreement resulting from the prudent exercise of an option; and (3) find these agreements replace all effective megawatts in Edison's Update solicitation, and that these agreements shall be in lieu of the Update capacity that would have otherwise have been awarded to bidders pursuant to Edison's Update solicitation.

4. In light of the determinations we make in Conclusion of Law Paragraph 3 above, the limited rehearing ordered in D.94-12-051 should be cancelled with respect to Edison and all effective megawatts in Edison's Update solicitation.

5. The Legislature has clearly delineated that costs associated with a Commission-approved settlement of the Update are uneconomic costs as set forth in PU Code § 367, and are eligible for recovery as transition costs as more specifically set forth in § 367.

6. When read together, PU Code § 367(a)(3) and § 381(c)(5) and (d) provide that 100% of Edison's Commission-approved Update settlement costs are eligible for transition cost recovery through December 31, 2001, after which 80% of the outstanding balance (if any exists) – up to a total of $90 million – is recoverable through March 31, 2002 from funds collected pursuant to § 381(d).

7. The priority expressly set out in PU Code § 381, indicates the Legislature's preference that the Edison Update settlements be funded before the additional $75 million is allocated to renewables (i.e., "Moneys remaining after fully funding the provisions of this paragraph [which addresses settlements concerning

Edison's Update auction] shall be reallocated for the purposes of paragraph (3)." (PU Code § 381(c)(5)).

8. Because we wish to resolve issues relating to Edison's Update solicitation expeditiously, this decision should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The Southern California Edison Company (Edison) Application for Approval of its Biennial Resource Plan Update (Update) Settlements is reasonable and in the public interest, and is approved.

2. We: (1) find the settlement package as a whole is reasonable and in the public interest and Edison's entering into these settlement agreements prudent; (2) authorize full recovery, through Edison's Transition Cost Balancing Account of payments made by Edison under these settlement agreements, and pursuant to any power purchase agreement entered into pursuant to the option settlements, subject to Edison's prudent administration of the settlement agreements and any power purchase agreement resulting from the prudent exercise of an option; and (3) find these agreements replace all effective megawatts in Edison's Update solicitation, and that these agreements shall be in lieu of the Update capacity that would have otherwise have been awarded to bidders pursuant to Edison's Update solicitation.

3. In light of the determinations we make in Conclusion of Law Paragraph 2 above, the limited rehearing ordered in Decision 94-12-051 is cancelled with respect to Edison and all effective megawatts in Edison's Update solicitation.

4. The separate motions of CalWind Resources, Incorporated, Windland Incorporated, and Zond Systems, Inc., to withdraw their respective pleadings are granted.

5. This proceeding is closed.

This order is effective today.

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

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