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Decision 98-12-074 December 17, 1998

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas and Electric Company (U 902-E) for an Ex Parte Order Approving the Settlement Agreements between SDG&E and certain winning bidders in SDG&E's Biennial Resource Plan Update Auction	Application 97-10-081 (Filed October 30, 1997)

Table of Contents

Pages

OPINION ON SAN DIEGO GAS & ELECTRIC COMPANY'S REQUEST FOR APPROVAL OF BIENNIAL RESOURCE PLAN SETTLEMENT

1. Summary

This decision addresses the application of San Diego Gas & Electric Company (SDG&E) requesting that the Commission approve as reasonable the package of settlements it has achieved with three bidders in the Biennial Resource Plan Update (Update) auction. The cost of the total settlement package is $5.095 million plus interest.

We find that the three settlements presented by SDG&E are reasonable and in the public interest and approve them. However, we defer consideration of SDG&E's request to terminate its Update solicitation at this time, and direct SDG&E and nonsettling bidders to engage in a further period of negotiation before we address SDG&E's request.

2. Background

2.1. The Update

In this application, SDG&E requests approval of a settlement package totaling $5.095 million, plus interest, and containing three settlements it has reached with certain bidders in SDG&E'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, SDG&E commenced its solicitation in the Update in compliance with our orders. On December 9, 1993, Southern California Edison Company (Edison) suspended its 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). On December 21, 1994, SDG&E filed a Petition for Modification of certain Update decisions, which raised some of the issues noted by Edison. 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. In D.94-12-051, the Commission denied, *inter alia*, SDG&E's application 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 had issued in D.94-10-039, and required SDG&E to negotiate additional terms and to submit FSO4 contracts to the Commission for approval by advice letter filing.

Following issuance of D.94-12-051, SDG&E and Edison filed petitions for enforcement with the Federal Energy Regulatory Commission (FERC) challenging the Commission's reinstatement of the solicitation and

[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.

seeking to enjoin the implementation of its 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 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 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

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[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).

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, upholding the February 23 FERC Order.

On July 5, 1995, the Assigned Commissioner issued a ruling (July ACR). 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 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 wished the Commission to approve. (*Id.* at 11.)

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[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 the public discussion so that it might provide guidance to the settling parties. (July ACR, slip op. at 1-2.) First enacted 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."

2.2. This Application

On October 30, 1997, SDG&E filed this application seeking approval of a settlement package containing settlements it has reached with three bidders that SDG&E stated may be "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 $5.095 million, plus interest. The total capacity of the "winning bidders" in SDG&E's solicitation is 501.5 megawatts (MW) of effective capacity, and these three settling bidders represent 108 MW of that effective capacity. The settling bidders include Magma Power Generating Company I (Magma), SeaWest Energy Corporation/Toyo Wind Power Corporation (SeaWest/Toyo), and Pacific Recovery Corporation (Pacific). SDG&E's filing includes Exhibits SDG&E-1 (copies of the settlement agreements) and SDG&E-2 (SDG&E's calculation of customer benefits of the settlement package). By their terms, several of the settlements expire on February 1, 1999 unless approved by the Commission before that date.

SDG&E's settlement package does not contain settlements with all of the bidders SDG&E designated as "winning bidders." Specifically, it excludes settlements with US Generating Company (US Generating) and Kenetech Windpower, Inc. (Kenetech), which together represent 393.5 MW of effective capacity. In its application, SDG&E states it negotiated with these remaining bidders in good faith, but believes negotiations are at an impasse.

SDG&E 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 SDG&E's application, as well as an opposition to SDG&E's motion for protective order. SDG&E and several settling bidders filed replies to ORA's motion. SDG&E withdrew its request that

the Commission include Exhibit SDG&E-2 within the purview of the requested protective order, but in all other respects continued to support its motion.

On March 27, the Assigned Commissioner and Administrative Law Judge (ALJ) held a prehearing conference. In its prehearing conference statement, ORA stated that it withdrew its opposition to SDG&E's motion for protective order in exchange for SDG&E's agreement to announce at the prehearing conference the aggregate settlement amount of its application. (SDG&E made public the aggregate settlement amount in its prehearing conference statement.) On April 2, 1998, SDG&E voluntarily filed and served a Revised Public Version of Exhibits. This Revised Public Version of Exhibits includes: (1) Exhibit SDG&E-1, containing copies of the settlement agreements, with the payment terms of the settlements redacted; and (2) the complete text of Exhibit SDG&E-2, the computation of benefits.

A May 28 Joint Assigned Commissioner and ALJ ruling (May 28 Ruling) granted SDG&E's protective order motion as amended by the stipulation as more fully set forth in the May 28 Ruling. At the prehearing conference, CalWind Resources, Inc. (CalWind) and Windland Incorporated (Windland), which were not bidders in SDG&E's solicitation and did not file a protest, nonetheless argued that hearings on SDG&E's application were necessary for the same reasons they believed hearings were necessary in Edison's application requesting approval of its Update settlements (Application (A.) 97-05-027). The May 28 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 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(d) which speaks to a $540 million payment for public purpose programs.

"4. If the Commission approves this application, is it also reasonable to terminate SDG&E's 1993 Update solicitation for new capacity, as has been requested by both SDG&E and ORA in their prehearing conference statements? What is the appropriate criteria to use in determining the reasonableness of this recommendation?

"5. Should the Commission grant all other relief requested by Edison's application? Why or why not?" (May 28 Ruling at 9-10.)

The following parties filed opening or reply briefs: SDG&E, Magma, SeaWest/Toyo and Pacific (jointly)[4]; ORA; and US Generating.

CalWind filed opening and reply briefs and subsequently made a motion to withdraw its briefs and opposition to the application. CalWind states that it has settled with the bidders with which Edison has settled and, as a result, now fully supports both SDG&E's and Edison's applications. CalWind states that it has agreed that if the Commission issues an order approving the Edison application in its entirety and without modification, CalWind will release all claims it may have against Edison, the settling bidders and SDG&E in this application, and in Edison's application (A.97-05-027), and in the Update proceeding. CalWind does not request Commission approval of its settlement, nor does it provide the specific terms thereof. Zond Systems Inc. (Zond) filed a reply brief in response to CalWind, and subsequently moved to withdraw its reply brief. We grant the separate motions of CalWind and Zond to withdraw their respective pleadings.

2.3. Parties' Positions

2.3.1. SDG&E and the Settling Bidders

SDG&E has entered into three settlement agreements totaling $5.095 million, plus interest, to resolve issues relating to SDG&E's Update solicitation with respect to the three settling bidders. SDG&E and the settling bidders refer to the settlements as "termination payments," where each settling bidder agrees to release any claims it may have against SDG&E concerning its

[4] SDG&E and the settling bidders filed a joint opening brief except as to Section II D, which contained arguments concerning the termination of SDG&E's 1993 Update solicitation, which were sponsored by SDG&E alone. SDG&E filed a reply brief on its own behalf.

Update solicitation in exchange for a "termination payment." SDG&E and the settling bidders state that the settlements are in the best interest of SDG&E's customers because they were negotiated in good faith under conditions of substantial uncertainty, fulfill the goals and requirements of the July ACR by reducing SDG&E's potential purchase power costs (net of the termination payments) by at least $343.4 million (1998 net present value (NPV)), and eliminate potential litigation by the settling parties.

SDG&E and the settling bidders believe that the reasonableness of the settlement package should be determined according to the criteria of the July ACR, and believe the settlements meet the criteria. This is so because the settlement, when viewed as a package, avoids future litigation with respect to the settling bidders, and avoids raising the cost of SDG&E's system as compared to the alternative of FSO4 contracts.

SDG&E and the settling bidders state that the expected savings to SDG&E customers will exceed $343.4 million (1998 NPV). This savings is derived by comparing the estimated purchase power costs associated with the Update contracts (*i.e.*, $348.5 million, which these parties state is arguably equal to or slightly less than the settling bidders' expectations), against the costs of the settlement agreements. SDG&E and the settling parties argue that assuming a 10% chance that the settling parties would prevail if they pursued litigation produces a probabilistic assessment valued at $34.85 million, and SDG&E proposes to pay only a small fraction of that. Therefore, these parties argue that no matter how the Commission views the settlement package, it is reasonable.

The settling bidders did not join SDG&E in addressing SDG&E's request to terminate its Update solicitation, nor did they join in SDG&E's reply brief. SDG&E believes that termination of the Update will allow

the Commission and the industry restructuring participants to turn their attention and resources more productively participating in the restructured electric industry. SDG&E does not believe that the July ACR required settlement with all bidders, because it recognized that settlement may not be achievable with every "winning bidder." SDG&E states it has made considerable effort over the last four years toward settling with all bidders it designated as "winning bidders," but settlement with all bidders has not been possible. SDG&E does not believe that the Edison settlements are comparable to SDG&E, because Edison entered into settlements with Kenetech, US Generating, and others, prior to FERC declaring the Update unlawful under PURPA, and prior to the issuance of the July ACR, whereas every settlement SDG&E executed occurred after the February 23 FERC Order and the July ACR. Under these circumstances, SDG&E urges the Commission to terminate its Update solicitation.

2.3.2. ORA

ORA believes that SDG&E has negotiated settlement agreements that comply with the letter and spirit of the July ACR, and that the settlements are reasonable and in the public interest. Accordingly, ORA recommends that the Commission approve SDG&E's Update settlements and allow SDG&E to recover the settlement costs and interest payments in rates in the manner requested by SDG&E in its application.

ORA believes that the Commission should determine the reasonableness of the settlements according to the criteria set forth in the July ACR. ORA believes that SDG&E followed the directives of the July ACR in negotiating settlements based on reasonable bid preparation and reliance costs, which process ORA believes is equitable because it approximates these bidders' reliance interests. ORA states that the ACR recognized that settlements that are in the ratepayers' interest may not be achievable with every winning bidder, and

believes that the Commission should approve this application even though it does not include all bidders designated by SDG&E as "winning bidders."

ORA believes that the settlement agreements are reasonable even though they include an interest component, so that the final amount paid to the winning bidders depends on the date the Commission finds the settlements reasonable. Ordinarily, ORA frowns on clauses which penalize the ratepayers for the Commission exercising its duties in a thorough manner rather than a hasty one. However, given the relative amount of interest included and the benefits to ratepayers associated with the settlements, ORA believes that the interest component is reasonable despite not knowing exactly when the Commission will approve the settlements.

ORA clarifies that it does not agree that the settlements are reasonable because of the alleged $343.4 million customer savings which SDG&E and the settling bidders say will occur. ORA believes that the Commission assesses settlements for reasonableness according to the "relationship of the amount agreed upon to the risk of obtaining the desired result." (*Re Pacific Gas and Electric Company*, D.88-12-083, 30 CPUC2d 189, 267 (*Diablo Canyon*).) ORA explains that the risk of obtaining the desired result is measured not just by estimating the costs associated with the worst possible scenario, but the probability of that scenario occurring. ORA disputes SDG&E's and the settling bidders' assumption that a 10% chance of the settling bidders obtaining their entire expectation interest under the FSO4 contract through litigation is pessimistic. Nonetheless, ORA continues to support the application because the settlements followed the July ACR and compensated the settling bidders for reasonable bid preparation or reliance costs.

ORA also supports SDG&E's request that the Commission terminate the Update solicitation with respect to SDG&E. ORA believes that the Commission has the jurisdiction to terminate the Update, as well as to determine whether or not an FSO4 contract exists, and also to determine whether or not to compel a utility to honor an admittedly valid QF contract. ORA does not believe any "winning bidders" have contractual rights to an FSO4 contract. Thus, ORA believes that terminating the Update for SDG&E is appropriate at this juncture.

2.3.3. US Generating

US Generating does not oppose the three settlements presented in this application, but it opposes the application because SDG&E seeks to conclude the Update without settling the remaining potential claims. US Generating points out that SDG&E's settlement package only accounts for 22% of the megawatts associated with SDG&E's Update solicitation for which the Commission encouraged settlement negotiations. US Generating believes that terminating the Update at this point would run counter to the July ACR and the Commission's desire to review the settlements as a package, and would almost certainly lead to litigation. US Generating believes the July ACR mandates that SDG&E settle with all bidders it designated as "winning bidders." US Generating also believes that the July ACR intended that the reasonableness of the settlement package, as opposed to each individual settlement, be reviewed because some individual settlements may not yield ratepayer benefits when viewed in isolation, although the entire settlement package, when taken as a whole, may provide for ratepayer benefits.

US Generating agrees with SDG&E that settlement negotiations are at an impasse. For this reason, US Generating recommends that the Commission give the parties a firm and clear directive to pursue good faith negotiations and establish a 45-day deadline within which the negotiations

should conclude. US Generating believes the Commission should explicitly address what will happen should the parties fail to reach agreement within the 45-day period, and should indicate its willingness to take any or all of the following steps: (1) order SDG&E and the remaining settling parties to meet with the Assigned Commissioner to discuss issues relevant to the impasse; (2) order mediated settlement talks, with the Energy Division acting as mediator; (3) order arbitration, with an ALJ or outside party acting as a neutral arbitrator; or (4) issue an order to show cause for SDG&E to explain why it has not reached a settlement with US Generating.

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 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 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 a 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, stating: "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.*)

3.2. Reasonableness of the Settlements

These applications technically present settlements which are not "all-party" settlements, because US Generating opposes the application. 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." However, ORA supports the application in full, and US Generating does not oppose the

Commission approving the three settlements, but only opposes SDG&E's request that the Commission terminate SDG&E's Update solicitation at this time.

Based on this record, we find that the settlement package, which contains the three settlements presented therein, is reasonable and in the public interest, and approve these three settlements. In assessing reasonableness, we are guided by the July ACR.

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 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 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 8.) The Assigned Commissioner elaborated in footnote 4 that he would personally view with disfavor buyout contracts that pay QFs more than their bid preparation or reliance interest and approximate an expectation interest. "The reason is plain: in a buyout strategy ratepayers will not gain the advantage of capacity additions." (July ACR at 9.)

Footnote 4 of the ACR elaborated on the full Commission's definition of a "buyout," and we reaffirm this footnote today, for our review of settlement packages such as this, in which all settlements were executed after the February 23 FERC Order and the July ACR. This does not mean that, in our assessment of litigation risk, we believe that all bidders designated by SDG&E as "winning bidders" are somehow legally entitled to receive their reliance interest. Rather, we view such payment as equitable, in light of the time and resources these particular bidders have committed to the lengthy and contentious Update

proceeding, which has not yet terminated, as well as their cooperation in engaging in this settlement process as directed by the July ACR.

Because SDG&E followed the direction of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs, we find the settlements reasonable and in the public interest.

We are strongly influenced by ORA's support, and find the settlement agreements reasonable and in the public interest even though they include an interest amount that depends on the date we approve the settlements. While ordinarily we might not approve such clauses, given the relative amount of interest included and the benefits to ratepayers associated with the settlements, and the fact that the settlements were negotiated over an extended period of time, we find this provision reasonable in this particular case.

The July ACR recognized the value to ratepayers of settlements that eliminate the potential for litigation flowing from the Update proceeding. The settlement package achieves this goal with respect to the settling bidders.

SDG&E and the settling bidders argue that the settlement package is also reasonable because the expected savings to SDG&E customers will exceed $343.4 million (1998 NPV). This savings is derived by comparing the estimated purchase power costs associated with the Update contracts (*i.e.*, $348.5 million, which these parties state is arguably equal to or slightly less than the settling bidders' expectations) against the costs of the settlement agreements. SDG&E and the settling parties argue that assuming a 10% chance that the settling parties would prevail if they pursued litigation produces a probabilistic assessment valued at $34.85 million, and SDG&E proposes to pay only a small fraction of that.

We base our findings of reasonableness on the fact that the settlements comply with the July ACR, but we do not agree with SDG&E's and the settling bidders' arguments of reasonableness on this additional ground. In *Diablo Canyon*, we 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 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.
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> "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.*)

SDG&E and the settling bidders stress that this settlement package is reasonable because it falls at the low range between $0 and $343.4 million. Yet, this type of analysis – assessing the risk by the amount in controversy rather than the relative strength of each party's case -- is precisely what *Diablo Canyon* cautioned against. In *Diablo Canyon*, the Commission was able to analyze specific testimony and witnesses that both PG&E and DRA planned to present before making its assessment of the relative strength of each party's case, and in turn, whether the settlement amount was reasonable.

In their briefs, SDG&E and the settling bidders fail to discuss with any specificity the strengths of their underlying positions at the time the July ACR was issued or at the time SDG&E executed the settlements in 1996. SDG&E

conceivably will argue that no settling bidder has any right to an FSO4 contract, and that, in light of, *inter alia*, the FERC ruling, the Commission should terminate the auction process. The settling bidders conceivably will argue, *inter alia*, that they have some type of vested rights by virtue of their status as "winning bidders," and some may argue that they already have valid FSO4 contracts. Yet, SDG&E and the winning bidders have not explained the parties' strengths, particularly, in a scenario in which the QFs prevail in litigation and receive their total expectation interest. Therefore, although we find the settlements reasonable based on the fact that they comply with the July ACR, we do not find the settlements reasonable on this alternative ground.

With respect to the three settlements that SDG&E has reached with Magma, SeaWest/Toyo, and Pacific, and which are contained in SDG&E's application, we: (1) find the settlement package to be reasonable and SDG&E's entering into these settlement agreements prudent; (2) authorize full recovery, through SDG&E's Transition Cost Balancing Account (TCBA), of payments made by SDG&E under these settlement agreements, subject to SDG&E's prudent administration of the settlement agreements; (3) find these agreements replace all 108 MW of effective capacity in SDG&E's Update solicitation associated with the Magma, SeaWest/Toyo and Pacific bids, and that these agreements shall be in lieu of the Update capacity that would have otherwise have been awarded to these settling bidders pursuant to SDG&E's Update solicitation; and (4) find SDG&E is not required to hold a rebid of the Update capacity covered by the settlement agreements.

3.3. SDG&E's Request to Terminate Its Update Solicitation

SDG&E's settlement package contains settlements with bidders representing 108 MW of effective capacity out of a total of 501.5 MW of effective capacity. SDG&E and ORA urge us to terminate SDG&E's Update solicitation at

this point, since SDG&E has reached an impasse with the remaining two bidders. US Generating, one of the remaining two bidders, urges that we order negotiations to resume and, if they are unsuccessful, that we mandate alternative dispute resolution (*i.e.*, mediation or arbitration), or that we issue an order to show cause against SDG&E to explain why settlement has not been reached.

The July ACR recognized the value to ratepayers of a settlement package that will eliminate the potential for any litigation flowing from the Update proceeding, and we are mindful of the fact that terminating all potential litigation flowing from the Update was an important reason for determining that settlement was the next logical step. However, we agree with SDG&E and ORA that the July ACR did not mandate settlement with every bidder no matter what the cost, and did not mandate that we find a settlement package which eliminates all potential litigation reasonable, no matter what the cost. As the ACR cautioned, the surest way to achieve settlement would be to assure the parties that any costs of the settlement would be fully recovered from the ratepayers so that QFs merely need to tell utilities how large a check to write. The ACR thus cautioned that we would not preapprove any settlement package, no matter what the amount, as long as litigation was eliminated.

The ACR also instructed the utilities to file with the Commission one application containing all the settlement agreements it wishes the Commission to approve. This does not mean that the utility could not file the package until it has achieved settlement with all bidders, because the utility may believe that it cannot achieve a reasonable settlement with a particular bidder.

The parties offer different rationale for why SDG&E has not been able to achieve what it believes to be a reasonable settlement with the remaining two bidders. However, we believe that the fact that Edison settled with these two bidders under different criteria and in a different timeframe (see

A.97-05-027) may have influenced this outcome. Simply put, when Edison's and SDG&E's total settlement figures are compared, ORA estimates that SDG&E settled for about 40% of Edison's total, when taking into account escalation factors. Put another way, ORA estimates that SDG&E's settlements totaled about $47,000/ MW of capacity settled.

Because of the passage of time since the July ACR issued, and the uncertainty which exists until this Commission acts on Edison's settlement package, we believe it may be beneficial to give SDG&E and the nonsettling bidders that SDG&E has designated as "winning bidders" additional time to discuss settlement before we address SDG&E's request to terminate its Update solicitation. We, therefore, direct these parties to resume settlement discussions, as set forth in this decision.

SDG&E and certain nonsettling bidders described above should continue to use the guidelines set forth in the July ACR, as modified and clarified by this decision, when they resume negotiations. The Commission will judge any remaining settlements presented by SDG&E as reasonable at the time they are entered into, and not at the time the July ACR issued.

SDG&E and the nonsettling bidders that SDG&E designated as "winning bidders" are directed to recommence settlement negotiations and to report to the Commission no later than 45 days after the effective date of this decision on the status of these negotiations (without disclosing any material which a party might allege is confidential because of the settlement process). This pleading should be filed in A.97-10-081 and served on the service list of that proceeding. Our expectation is that this pleading will state that the parties have or are close to arriving at an agreement. At that juncture, we can then determine the best next appropriate step in addressing SDG&E's request to terminate its Update solicitation.

We recognize that our ALJ Division contains many ALJs who are trained in mediation. If both SDG&E and a nonsettling bidder believe that mediation under Commission auspices will assist in resolving their particular dispute, the two parties should jointly contact the Chief ALJ who can make arrangements for mediation assistance. In our experience, mediation is successful if it is voluntary rather than mandated by the Commission.

3.4. 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 (*i.e.*, the 80% limitation applies to whatever portion of the settlement amounts approved by the Commission that SDG&E has not recovered by December 31, 2001.)

PU Code § 381(d) applies to Edison but not to SDG&E. Therefore, it is not necessary to address the interplay between § 367 and § 381 for SDG&E.

4. Comments to the Draft Decision

Although not required by Public Utilities Code § 311(d), the draft decision of ALJ Econome was mailed to the parties for comment 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: SDG&E, ORA, and US Generating. We make the following changes to the draft decision: We: (1) clarify the guidelines by which SDG&E and certain nonsettling bidders should continue to negotiate (see Section 3.3); (2) add that SDG&E is not required to hold a rebid of the Update capacity covered by the settlement agreements (see Section 3.2); and (3) clarify that the TCBA is the appropriate account through which SDG&E should recover payments made pursuant to these settlement agreements (see Section 3.2). We also make changes to the draft decision to improve the discussion and to correct typographical errors, and make corresponding changes to the findings of fact, conclusions of law, and ordering paragraphs to incorporate the above changes.

We also add this Section 4 to the draft decision.

Findings of Fact

1. In this application, SDG&E requests approval of a settlement package of $5.095 million, plus interest, containing three settlements it has reached with certain bidders in SDG&E's Update auction.

2. SDG&E and the settling bidders refer to the settlements as "termination payments," where each settling bidder agrees to release any claims it may have against SDG&E concerning its Update solicitation in exchange for a "termination payment." SDG&E and the settling bidders state that the settlements reduce SDG&E's potential purchase power costs (net of the termination payments) by at least $343.4 million (1998 NPV).

3. In assessing the reasonableness of the settlement package, we are guided by the July ACR.

4. 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.

5. 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."

6. SDG&E followed the direction of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs.

7. Every settlement SDG&E executed occurred after the February 23 FERC Order and the July ACR.

8. In *Diablo Canyon*, we 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 276.)

9. SDG&E and the settling bidders stress that this settlement package is reasonable because it falls at the very low range between $0 and $343.4 million. Yet, this type of analysis – assessing the risk by the amount in controversy rather than by the relative strength of each party's case -- is precisely what *Diablo Canyon* cautioned against.

10. In their briefs, SDG&E and the settling bidders fail to discuss with any specificity the strengths of their underlying positions at the time the July ACR was issued, or at the time SDG&E executed the settlements in 1996.

11. We base our findings of reasonableness on the fact that the settlements comply with the July ACR, but we do not agree with SDG&E's and the settling bidders' arguments of reasonableness on the additional ground of customer benefits exceeding $343.4 million (1998 NPV).

12. The July ACR recognized the value to ratepayers in a settlement package that will eliminate the potential for any litigation flowing from the Update proceeding, and we are mindful of the fact that terminating all potential litigation flowing from the Update was an important reason for determining that settlement was the next logical step. However, the July ACR did not mandate settlement with every bidder no matter what the cost, and did not mandate that we find a settlement package which eliminates all potential litigation reasonable, no matter what the cost.

13. The July ACR also instructed each utility to file with the Commission one application containing all the settlement agreements it wished the Commission to approve. This does not mean that the utility could not file the package until it has achieved settlement with all bidders, because the utility may believe that it cannot achieve a reasonable settlement with a particular bidder.

14. Because of the passage of time since the July ACR issued, and the uncertainty which exists until this Commission acts on Edison's settlement package, it may be beneficial to permit SDG&E and the nonsettling bidders that SDG&E has designated as "winning bidders" additional time to discuss settlement before we address SDG&E's request to terminate its Update solicitation.

15. We will judge any remaining settlements presented by SDG&E as reasonable at the time they are entered into, and not at the time the July ACR issued.

16. PU Code § 381(d) applies to Edison but not to SDG&E. Therefore, it is not necessary to address the interplay between § 367 and § 381 for SDG&E.

Conclusions of Law

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

2. The separate motions of CalWind and Zond to withdraw their respective pleadings should be granted.

3. Footnote 4 on page 9 of the July ACR stated the view of the Assigned Commission 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. This footnote elaborated on the full Commission's definition of a "buyout," and it should be reaffirmed today for our review of settlement packages such as this, in which all settlements were executed after the February 23 FERC Order and the July ACR. This does not mean that, in our assessment of litigation risk, we believe that all bidders designated by SDG&E as "winning bidders" are somehow legally entitled to receive their reliance interest. Rather, such payments should be viewed as equitable, in light of the time and resources these particular bidders have committed to the lengthy and contentious Update proceeding, which has not yet terminated, as well as their cooperation in engaging in this settlement process as directed by the July ACR.

4. The three settlements which SDG&E achieved with the three settling bidders are reasonable and in the public interest.

5. While ordinarily we might not approve settlements which include an interest component based on the date we approve the settlement, given the relative amount of interest included and the benefits to ratepayers associated with the settlements, and the fact that the settlements were negotiated over an extended period of time, we find the interest provision reasonable in this particular case.

6. With respect to the three settlements that SDG&E has reached with Magma, SeaWest/Toyo, and Pacific, and which are contained in SDG&E's application, we: (1) find the settlement package to be reasonable and SDG&E's entering into these settlement agreements prudent; (2) authorize full recovery, through SDG&E's TCBA, of payments made by SDG&E under these settlement agreements, subject to SDG&E's prudent administration of the settlement agreements; (3) find these agreements replace all 108 MW of effective capacity in SDG&E's Update solicitation associated with the Magma, SeaWest/Toyo and Pacific bids, and that these agreements shall be in lieu of the Update capacity that would have otherwise have been awarded to these settling bidders pursuant to SDG&E's Update solicitation; and (4) find that SDG&E is not required to hold a rebid of the Update capacity covered by the settlement agreements.

7. SDG&E and the nonsettling bidders that SDG&E has designated as "winning bidders" should resume settlement discussions as set forth in this decision. SDG&E and these nonsettling bidders should continue to use the guidelines set forth in the July ACR, as modified and clarified by this decision, when they resume negotiations. The Commission will judge any remaining settlements presented by SDG&E as reasonable at the time they are entered into, and not at the time the July ACR issued.

8. SDG&E and the nonsettling bidders that SDG&E has designated as "winning bidders" are directed to recommence settlement negotiations and to report to the Commission no later than 45 days after the effective date of this decision on the status of these negotiations (without disclosing any material which a party might allege is confidential because of the settlement process). This pleading should be filed in A.97-10-081 and served on the service list of that proceeding.

9. If both SDG&E and a nonsettling bidder believe that mediation under Commission auspices will assist in resolving their particular dispute, the two parties should jointly contact the Chief ALJ who can make arrangements for mediation assistance.

10. 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.

11. Because we wish to resolve issues relating to SDG&E's Update solicitation expeditiously, this decision should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The San Diego Gas & Electric Company (SDG&E) Application for Approval of Its Biennial Resource Plan Update (Update) Settlements is approved to the extent we approve the three settlement agreements presented in the application.

2. With respect to the three settlements that SDG&E has reached with Magma Power Generating Company I (Magma), SeaWest Energy Corporation/Toyo Wind Power Corporation (SeaWest/Toyo), and Pacific Recovery Corporation (Pacific), and which are contained in SDG&E's application, we: (1) find the settlement package to be reasonable and SDG&E's entering into these settlement agreements prudent; (2) authorize full recovery, through SDG&E's Transition Cost Balancing Account, of payments made by SDG&E under these settlement agreements, subject to SDG&E's prudent administration of the settlement agreements; (3) find these agreements replace all 108 megawatts of effective capacity in SDG&E's Update solicitation associated with the Magma,

SeaWest/Toyo and Pacific bids, and that these agreements shall be in lieu of the Update capacity that would otherwise have been awarded to these settling bidders pursuant to SDG&E's Update solicitation; and (4) find that SDG&E is not required to hold a rebid of the Update capacity covered by the settlement agreements.

3. SDG&E and the nonsettling bidders that SDG&E has designated as "winning bidders" shall recommence settlement negotiations based on the rationale set forth in this decision, and shall to report to the Commission no later than 45 days after the effective date of this decision on the status of these negotiations (without disclosing any material which a party might allege is confidential because of the settlement process). This pleading shall be filed in Application 97-10-081 and served on the service list of that proceeding.

4. If both SDG&E and a nonsettling bidder believe that mediation under Commission auspices will assist in resolving their particular dispute, the two parties shall jointly contact the Chief Administrative Law Judge who can make arrangements for mediation assistance.

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

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