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Decision 99-02-085 February 18, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	Rulemaking 94-04-031 (Filed April 20, 1994)
Order Instituting Investigation on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation.	Investigation 94-04-032 (Filed April 20, 1994)

OPINION ON QUALIFYING FACILITY CONTRACT MODIFICATION ISSUES

1. Summary

This decision rejects the June 10, 1998 joint motion of Southern California Edison Company (Edison), Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Independent Energy Producers Association (IEP), California Cogeneration Council (CCC), NRG Energy, Inc. (NRG Energy), and Enron Capital & Trade Resources (Enron) proposing the adoption of a settlement agreement on qualifying facility (QF) contract restructuring and modification issues.

This decision also individually addresses the issues of (1) the standard of reasonableness the Commission applies to a QF[1] contract restructuring or

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

modification; (2) whether QF contract restructurings should be voluntary for both the utility and the QF; (3) whether a utility's decisions in QF contract restructuring negotiations should be subject to reasonableness review; (4) whether to retain and how to implement the 10% shareholder incentive to renegotiate QF contracts, as well as other QF-related issues raised by the parties.

This decision also denies the Office of Ratepayer Advocates' (ORA) Petition for Modification of Decision (D.) 96-12-077, and dismisses without prejudice Enron's Motion Requesting an Order to Show Cause Against Edison, dated July 22, 1997.

2. Procedural Background

D.96-12-088 (the Roadmap 2 Decision) requested interested parties to file proposals to establish a generic method to review contract modifications, possibly including standard measures of reasonableness, and possibly involving an expedited process. (D.96-12-088, *slip op.* at Ordering Paragraph 3.) The Roadmap 2 Decision also stated that the process established to review contract modifications should respect the principles outlined in D.95-12-063, as modified by D.96-01-009, the Commission's Preferred Policy Decision in this docket.

Since the issuance of D.96-12-088, the parties have filed proposals, the Commission has conducted a workshop, the Energy Division has issued a workshop report, and Assigned Commissioner Neeper held two all-party meetings to discuss these issues. In their proposals, at the workshop, and at the all-party meetings, numerous parties have raised a variety of issues.

On February 6, 1998, Assigned Commissioner Neeper and Administrative Law Judge (ALJ) Econome issued a ruling setting forth at least four issues which are appropriate for the Commission to address now in order to further facilitate QF contract restructuring or modification and Commission review thereof. The ruling also established a briefing schedule on these issues.

The first issue set forth in the February Ruling, whether the Commission should adopt the Qualifying Facility Restructuring Reasonableness Letter (QFRRL) proposal, is addressed by a separate Commission decision because the ruling's remaining issues are more complex, and a separate decision on the QFRRL proposal would expedite resolution of that one issue.

The remaining issues set forth in the ruling are the subject of this decision.

> "2. What should be the Commission's standard of reasonableness for approving a QF contract restructuring or modification?
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> "3. Should negotiations between QFs and utilities with respect to QF contract restructuring or modification be voluntary? Should utility decisions on contract restructuring or modification be subject to reasonableness review?
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> "4. How should the shareholder incentive mechanism adopted in the Commission's Preferred Policy Decision be implemented? Please discuss, inter alia, how the incentive mechanism should be calculated, tracked, and recorded.
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> "5. Set forth any other critical issues you believe necessary for the Commission to address now in order to facilitate QF contract restructuring or modification, and Commission review thereof. Fully set forth your recommended resolution, the reasons therefor, the applicable Commission law and policy, and whether your recommendation is consistent with this law or policy or is a change therefrom." (February 6, 1998 Ruling at p. 3.)

The following parties filed comments or replies pursuant to the February 6 ruling: California Integrated Waste Management Board; Enron; IEP/CCC (jointly); NRG Energy; ORA; Joint Comments of Edison, PG&E, and SDG&E (Joint Utility Commenters); Southern California Gas Company (SoCalGas); and

Watson Generation Company (Watson).[2] There was little consensus among the parties on these issues.

On June 10, 1998, the Joint Utility Commentors, IEP/CCC, NRG Energy, and Enron (settling parties) filed a motion proposing the adoption of a settlement agreement on QF contract restructuring and modification issues. The following parties filed comments, oppositions, or replies to the proposed settlement: the settling parties (jointly); ORA; SoCalGas, The Utility Reform Network (TURN); and Watson.

3. The Settlement

3.1 The Settlement Provisions

The settling parties propose that the Commission adopt the following settlement in order to resolve outstanding issues regarding QF contract restructuring:

> "1. A QF contract restructuring is reasonable and should be approved if it provides ratepayer benefits under a range of reasonable economic and operating assumptions and the benefits have been allocated through voluntary, arm's length negotiations between utilities and QFs or their representatives.
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> "2. QF contract restructuring negotiations are voluntary for both utilities and QFs and QF contracts may be modified only by the parties upon their mutual agreement. Although agreements to restructure QF contracts are subject to Commission review, utility

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[2] On May 12, 1998, SoCalGas filed a motion to file reply comments to Watson's comments, with the reply comments attached thereto. Watson has filed a response opposing the motion. Finding no prejudice to any party, we grant SoCalGas' motion to file the reply comments.

> restructuring decisions or actions that do not result in a restructuring agreement are not subject to reasonableness review.
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> "3. The shareholder incentive should be 10% of the expected ratepayer benefits approved in D.96-12-077. In this regard, the Settling Parties agree that the Commission should deny the ORA's Petition for Modification of D.96-12-077, dated February 14, 1997. (Settling Parties' joint motion proposing adoption of the settlement agreement at pp. 2-3. The entire settlement agreement is attached to this decision as Attachment A.)

The settling parties agree that the Commission's adoption of the above principles will fully address issues 2-4 set out in the February 6 ruling and will eliminate further discussions and Commission proceedings regarding these issues. For example, if adopted, the settlement provides that Enron will withdraw its "Motion Requesting an Order to Show Cause Against Southern California Edison Company" dated July 22, 1997. The settlement also addresses issue number 5 in the February 6 ruling by adopting the following proposal, prior to which the parties agree that they will engage in a "participatory process" to discuss and attempt to resolve the following issues before making Commission filings regarding these issues.

"At the appropriate time, either this or another Commission proceeding will address:

- Transitioning short run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in Public Utilities code Section 390;

- Other suggestions to achieve ratepayer benefits through QF contract restructurings including proposals to use securitized bonds to finance the buyout or buydown of QF contracts, divestiture of all, or a portion of Edison's and PG&E's QF contract portfolios, or other such suggestions." (Settlement Agreement at p. 6.)

The settling parties state that this settlement consists of a compromise of all the issues set forth, which could not have been reached if the parties were addressing each issue individually. Thus, they stress that the Commission should view the agreement as a whole, that all components of the settlement are interrelated, and that the elimination, or even rewording, of any one of the principles adopted in the settlement will render the settlement unacceptable to some or all of the parties. Thus, if the Commission does not adopt the settlement in its entirety, the settling parties withdraw their support and revert to the positions advocated in their opening and reply briefs filed pursuant to the February 6 ruling.

The settling parties believe that the settlement, when taken as a whole, is a reasonable compromise between competing interests, and also is beneficial to ratepayers. The settlement's proposed reasonableness standard eliminates a review standard of "commensurate ratepayer benefits", which certain QFs believe is vague. Thus, the settling parties believe that more QFs will be willing to enter into contract restructuring negotiations because of the greater certainty in the standard of reasonableness. The settling parties believe that the portions of the agreement that require (1) restructuring benefits be allocated through voluntary, arm's length negotiations; (2) that the restructured contract provide benefits under a range of reasonable economic and operating assumptions; and (3) that only consummated restructuring agreements will be subject to reasonableness review, provides the proper negotiating environment for the utility to negotiate beneficial agreements on behalf of ratepayers.

According to the settling parties, the 10% shareholder incentive also operates as an inducement for utilities to negotiate and consummate contract restructurings that yield ratepayer benefits. The settling parties also believe that, notwithstanding ORA's strong opposition to this settlement, ORA's ability to advocate the interests of the ratepayer is not diminished, since every restructuring proposal for Commission approval is subject to comment by ORA. As a practical matter, if the settlement is approved, parties to the proposed restructuring agreements will attempt to anticipate and account for ORA's concerns in order to take advantage of the expedited review procedure afforded by the QFRRL procedure, which is the subject of a separate decision. Finally, the settling parties believe that the proposed "participatory process", and the Commission's agreement to review several issues in the future will result in the withdrawal of several motions and eliminate the need for further briefing concerning the February 6 ruling. Thus, they believe this portion of the proposal will conserve the parties' and the Commission's time and resources.

The settling parties believe that Watson's suggested modification (discussed below) to utility reasonableness review of utility decisions which do not result in a restructuring agreement is unnecessary because if negotiations are truly voluntary on both sides, all parties should be free to propose terms without the threat of any reasonableness review. The settling parties also believe that SoCalGas' proposed modifications to the agreement to include gas ratepayers in the definition of ratepayers used by the settlement should be rejected because of the risk that restructurings that would otherwise provide demonstrable ratepayer benefits will not be consummated based on an entirely speculative concern that gas ratepayers may be affected by lost revenues associated with reduced throughput.

3.2 Responses and Oppositions

ORA

ORA strongly opposes the settlement because it represents a balance between the private interests of QFs and utility shareholders, but does not consider California ratepayer interests. ORA states that it declined to participate in settlement discussions because the initial proposals of the settling parties contained no proposals which benefited ratepayers. ORA believes that each element of the settlement sacrifices ratepayer benefits and protections for gain to QFs and utilities. For example, ORA believes that the reasonableness review standard is inadequate and, compared with the existing standard, will eliminate ORA's ability to oppose a QF restructuring which provides an inadequate level of ratepayer benefits, or which overcompensates the QF or utility shareholders. Put another way, ORA believes that the proposed reasonableness standard would deprive ratepayers of any opportunity to oppose contract restructurings which parties freely negotiate and which produce a single dollar of benefits for ratepayers.

ORA also believes that since ratepayers bear the cost of QF contracts, utilities are required to act reasonably and to demonstrate the reasonableness of their actions with regard to QF contracts through clear and convincing evidence. ORA believes that the settlement agreement would eliminate ORA's and the Commission's ability to examine the utilities' negotiating practices for reasonableness, and the Commission's ability to make a finding of imprudence where the utility has failed to execute a beneficial restructuring for ratepayers. ORA believes that it is an appropriate and relatively minimal risk for utilities to be ready to demonstrate that their conduct during QF contract renegotiations is reasonable, based upon facts known or which should have been known at the time.

ORA also believes that the Commission should modify the shareholder incentive adopted in D.95-12-063 based on forecasted savings. ORA believes that the incentive mechanism should be eliminated because it may create an incentive for the utilities to exaggerate ratepayer benefits. Alternatively, if the Commission maintains the mechanism, ORA believes it should be based on actual savings realized by the ratepayers, and not a forecast proposed by the utility at the time the QF contract is restructured.

TURN

TURN did not take an active role in these issues until late in the proceeding, when it addressed the settlement agreement. TURN states that, although it would strongly prefer to see a negotiated resolution of many of the outstanding issues surrounding QF contract restructuring, it believes that the settlement agreement contains misaligned incentives. TURN focuses its concern on the 10% shareholder incentive mechanism, and believes that the settlement encourages the utilities to forecast, but not achieve, ratepayer benefits. TURN agrees with ORA's proposal for implementing the shareholder incentive mechanism by a share of the actually-realized ratepayer benefits. Furthermore, TURN believes that forecasts are often wrong, and since the utility and QF both want to secure Commission approval of the agreement they have reached, they both will have an incentive to overstate the potential ratepayer benefits.

SoCalGas

SoCalGas does not support the settlement as written. SoCalGas believes that, since the gas entity is excluded from the negotiation process, the settlement does not allow SoCalGas and its ratepayers to develop facts bearing on gas ratepayer and gas utility impacts for Commission consideration in advance of the execution of a renegotiated QF contract. SoCalGas believes that if it approves the settlement, the Commission should condition its approval on a requirement that QF restructuring parties present to the Commission consideration of the harm, or lack thereof, to gas ratepayers resulting from any QF restructuring, and demonstrate that such showing was developed in cooperation with the affected gas utility and its ratepayers.

Watson

Watson's sole concern is the second provision of the settlement agreement, specifically, the provision that the utility shall be free from reasonableness reviews of unconsummated QF contract restructuring transactions. Watson believes that this provision, if interpreted broadly, may stifle competition in California's new electric market by giving the utilities control over how power from QF projects can compete in the new market after their contracts are restructured. As an example, Watson states that under the settlement agreement, a utility could refuse to restructure a QF contract unless the QF agrees not to use the freed-up power to compete directly with the utility's transmission and distribution services. According to Watson, approving the settlement agreement would commit the Commission not to review the reasonableness of such a utility refusal, even if that issue was the only obstacle to an otherwise beneficial deal.

Accordingly, if the Commission approves the settlement, Watson asks the Commission to make clear its limited scope. That is, the Commission should clarify that its approval of the settlement does not permit a utility, in the contract restructuring process, to restrict a QF's future competitive options for power that will no longer be sold under a utility/QF power purchase contract and will be available on the open market. Watson believes this clarification is consistent with Public Utilities (PU) Code § 372, which establishes detailed provisions for the competitive options that cogeneration QFs will have in the new marketplace. Watson believes that the competitive benefits from QF contract restructuring will be reduced if the utilities are allowed to condition contract buyouts or buydowns on QFs agreeing not to engage, after contract termination, in competitive transactions that are otherwise allowed and encouraged under California law.

3.3 Standard of Review

Rule 51.1 (e) of the Commission Rules of Practice and Procedure (Rules) 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." We apply these criteria to the settlement before us.

In D.92-12-019, 46 CPUC2d 538, we refined our policy toward settlements by setting forth criteria which would characterize an all-party settlement. The first criterion is that the settlement must enjoy "the unanimous sponsorship of all parties to the instant proceeding." All active parties in this proceeding do not support the settlement. Because the settlement does not meet the first criterion of an all-party settlement, is not necessary for us to address the remaining criteria. We will consider the settlement under the three criteria set forth in Rule 51.1(e).

> "Our standard of review, however, is somewhat more stringent. Here, we consider whether the settlement taken as a whole is in the public interest. In so doing, we consider individual elements of the settlement in order to determine whether the settlement generally balances the various interests at stake as well as to assure that each element is consistent with our policy objectives and the law." (D.94-04-088, 54 CPUC2d 337, 343.)

3.4 Discussion

The settling parties vociferously argue that their settlement is in the ratepayers' best interest. Yet, the parties which represent the ratepayers' interest, ORA and TURN, do not support the settlement. In fact, ORA asks the Commission to reject all elements of the settlement.

Based on this record, we cannot determine that the settlement, when taken as a whole, is fair to the ratepayers', and is therefore in the public interest. The settling parties believe, for example, that the Commission should adopt the "ratepayer benefit" instead of "commensurate ratepayer benefit" standard in order to determine the reasonableness of a restructured contract, and should also eliminate Commission reasonableness review for a utility's actions in QF contract renegotiations which do not lead to a restructured contract. The settling parties argue that the 10% shareholder incentive, as well as the "arms-length" negotiations between the QF and the utility, will protect the ratepayer interests.

We are not so persuaded. For example, although the utility is charged with representing the ratepayers' interest in QF contract negotiations, it, or its affiliates, may also be a potential competitor with some of these QFs in the emerging competitive electric market. Also, some QF restructuring contracts involve a utility and its QF affiliate.

For this reason, we do not believe that the settlement provisions, which state that the utility's and QF's showing that negotiations are ones of "arms length", and which provide for the 10% shareholder incentive, are adequate provisions to ensure that the resulting restructured contracts will be in the ratepayers' best interest. In reaching this conclusion, we are particularly influenced by ORA's stringent opposition to virtually every element of the settlement. We therefore reject the settlement as not adequately protecting ratepayers and thus, as not being in the public interest. Consequently, we examine each issue raised by the February 6 ruling individually.

4. Reasonableness Review Standard

4.1 Parties' Positions

The February 6, 1998 ruling directed that the parties address the following issue: "What should be the Commission's standard of reasonableness for approving a QF contract restructuring or modification?"

The Joint Utility Commenters recommend that the Commission adopt the following reasonableness review standard: "A QF contract restructuring is reasonable and should be approved if it provides commensurate ratepayer benefits under a range of reasonable economic and operational assumptions, and restructuring benefits are reasonably allocated through voluntary, arm's length negotiations between utilities and QFs or their representatives."

The Joint Utility Commenters believe that the "commensurate ratepayer benefit" standard provides the best opportunity to meaningfully lower ratepayer costs and represents a continuation of the Commission's traditional standard for assessing the reasonableness of QF contract amendments, citing to D.88-10-032, 29 CPUC2d 415. They believe that a simple "ratepayer benefits" standard suggests that any quantifiable amount of ratepayer savings is sufficient, but this standard might not be in the ratepayers' best interest if it does not also represent a fair sharing of each party's respective costs, benefits, and risks compared to the status quo. The Joint Utility Commenters also argue that if either party, the utility and ratepayers, or the QF, expects to receive all, or almost all, of the benefits from a restructuring, the end result is likely to be no or limited restructuring activity. However, the Joint Utility Commenters' proposed standard would encourage the parties to seek a fair allocation of benefits, which would allow more restructurings to occur.

The Joint Utility Commenters believe that the standard for determining the reasonableness of a QF contract restructuring must be based upon a reasonable range of economic and operational assumptions, including an assessment of any facts that materially affect project viability.

ORA's proposed standard is similar, but not identical, to that of the Joint Utility Commenters. ORA suggests that the Commission adopt the following standard: "A QF contract restructuring is reasonable and should be approved if it provides commensurate ratepayer benefits under a range of reasonable economic and operational assumptions. The determination of commensurate benefits should consider the relative value of ratepayer benefits to the cost and risk of the restructuring, and to the projected benefit of the restructuring to the QF."

ORA believes that the Commission should adopt its standard in lieu of the Joint Utility Commenters, because ORA's recommended standard considers an allocation of benefits between the ratepayer and QF, and that an assertion that a restructuring was voluntarily negotiated at arms length does not in itself demonstrate reasonable allocation. ORA states that in applications to date, the utilities have attempted to demonstrate a reasonable allocation of restructuring benefits through a showing of the projected restructuring benefit to the QF based on actual or projected economic and operating variables. ORA believes that this should continue to be part of the utilities' showing.

ORA argues that QF contract restructurings should provide commensurate ratepayer benefits under a broad range of reasonable economic and operational assumptions, and that this standard is consistent with Commission policy, including D.88-10-032. ORA believes that a standard of ratepayer benefit, without qualification on the amount of ratepayer benefit, does not provide enough ratepayer protection from restructurings which disproportionately benefit QFs.

Various QF parties, including Enron, IEP/CCC, NRG Energy, the California Integrated Waste Management Board, and Watson believe that the reasonableness standard should be based solely on ratepayer benefit, without regard for the QFs situation. This position is similar to that advocated by the settling parties in the settlement discussed above. IEP/CCC believe that the Commission should approve any contract restructuring freely negotiated between the utility and QF that yields "ratepayer benefit under a range of reasonable economic and operating assumptions." (IEP/CCC March 25, 1998 comments at p. 2.) The QF parties believe that their recommended standard is consistent with the Commission's decision on the "Year 11" contract restructuring issues in D.94-05-018, 54 CPUC2d 383. These parties argue that since payments made under QF contracts have already been determined to be just and reasonable as a matter of law and Commission decision, if payments under the restructured contract do not exceed payments under the original contract, the restructured contract must be just and reasonable.

Most of the QF parties believe that the "commensurate" standard is vague and will confuse, rather than facilitate, successful contract restructurings. Citing D.94-05-018, Watson believes that the Commission's past use of "commensurate" ratepayer benefits means that the ratepayer benefits from a restructuring transaction must be in proportion to the risks that ratepayers bear in agreeing to the proposed modification.

The QF parties also note that they strongly believe that contract restructurings should not involve consideration of the QF contract holder's projected future financial position (such as expected net operating income under the existing contract) and consideration of the QF's hypothetical future business opportunities, such as direct sales access. The QF parties believe that such considerations are irrelevant to the ratepayers' position, are highly speculative, may be invasive of proprietary and competitive business information, are necessarily contentious, and will ultimately discourage the restructuring process.

SoCalGas does not address this generic issue, but rather addresses an issue more specific to itself. We discuss this issue in Section 7.

4.2 Discussion

We begin our discussion by reviewing the existing Commission reasonableness standard for reviewing QF contract restructurings. In

D.88-10-032, 29 CPUC2d 415 (1988) (QF Contract Administration Guidelines Decision), the Commission determined that modification of a QF contract "should only be agreed to if commensurate concessions are made to the benefit of ratepayers." (29 CPUC2d at 437-438, Conclusion of Law 3.) The Commission further determined that modification of a QF contract is justifiable only when accompanied by price or performance concessions "commensurate in value" with the degree of change in the contract.

> "QFs do not have an automatic right to modify a standard offer --- nor do utilities have an obligation to agree to any and all requested changes. A utility should agree to modify only if commensurate concessions are made to benefit ratepayers." (29 CPUC2d at 426.) ...
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> "Contract modifications requested by QFs must be accompanied by price and/or performance concessions (e.g., adders such as dispatchability, voltage support, and emergency availability), commensurate in value with the degree of the change in the contract (from minor to major). The modifications and concessions obtained through negotiation should be valued with reference to the unamended contract and, where appropriate, (e.g., deferrals and performance concessions), the current and expected value of the QF's power." (Guideline I.1, 29 CPUC2d at 440.) ....
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> "On-line date deferrals and/or contract buyouts may be considered only if the ratepayers' interests will be served demonstrably better by such deferral." (Guideline III.7, 29 CPUC2d at 441.)

In our Opinion on Guidelines for Year 11-Related Restructuring, D.94-05-018, 54 CPUC2d 383, we reiterated a limited exception to our general rule that we first stated in D.93-02-048, with respect to year-11 related contract restructurings.[3] In that narrow instance, we stated:

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[3] The "year 11-issue" contracts are based on the Interim Standard Offer 4 (ISO4) approved by the Commission in D.83-09-054, 12 CPUC2d 604, and subsequent

Footnote continued on next page

"[T]he modifications should be structured so that ratepayers are no worse than indifferent, on a net present value basis, to the choice between the proposed modification and continuing with the existing ISO4 contract. In light of the high payments that ratepayers have already made under ISO4, we think it desirable that modifications, whenever feasible, offer ratepayers some economic gain." (*Id.* at p. 388.)

Other Commission decisions have not been consistent in implementing these standards. For example, in some of our past decisions addressing utility applications requesting approval of QF buyouts, the Commission has not articulated the standard adopted in the QF Contract Administration Guidelines Decision, but, on this issue, has required a persuasive showing that the buyout will benefit ratepayers more than keeping the contract in place.[4]

In the QF Contract Administration Guidelines Decision, the Commission explained that QF standard offer contracts "were developed as 'package deals' – the price and performance requirements were considered, as a whole, to be reasonable to ratepayers, and automatic approval of those terms by the Commission was guaranteed." (29 CPUC2d at 426.)

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decisions. The payment structure of ISO4, combined with developments in fuels markets and other circumstances, will result in a sudden drop in payments to some QFs after the tenth year of the contract (the year 11 issue).

[4] See San Diego Gas & Electric Company, D.94-12-038; Southern California Edison Company, D.95-10-041, D.95-11-058, D.97-02-013, D.97-02-050, D.98-02-112, D.98-09-073; Pacific Gas and Electric Company, D.98-01-016. These decisions also require a persuasive showing that the QF generating facility is a viable one that would not likely shut down prior to completing the contract.

The "ratepayer benefit" standard proposed by the QFs (and also by the settlement) suggests that any amount of quantifiable ratepayer savings is sufficient for purposes of finding a restructured QF contract reasonable, and the fact that the QF and utility state they are negotiating at "arms-length" will ensure that ratepayers receive appropriate benefits under the restructured contract.

The QFs argue that any standard other than their proposed "ratepayer benefit" standard is ambiguous and will discourage further contract restructurings. They also argue that a QF will not want to disclose any of what it believes to be confidential operating information to the utility in negotiations, because the utility may currently or shortly be its competitor in the newly competitive marketplace.

The Draft Decision issued on October 21, 1998 in this proceeding would have adopted the "commensurate ratepayer benefit standard" from the original QF contract administration guidelines as our standard for all QF contract restructuring applications filed on or after the issuance of this decision. The Draft Decision's standard would have been that the restructuring or modification should provide commensurate ratepayer benefits under a range of reasonable economic and operational assumptions, and should represent an equitable allocation and balancing the benefits between ratepayers and the QF.

In comments to the Draft Decision, the settling parties argue that the Draft Decision's proposed resolution of the issues represents a significant step backwards in the Commission's efforts to achieve its restructuring goals. For example, the settling parties oppose the commensurate ratepayer benefit standard because the QFs have historically opposed this standard as vague and irrelevant. Watson states that the Draft Decision merely restates existing longstanding CPUC policies on QF contract restructuring. ORA also points out that the clarifications in the Draft Decision do not diverge from established precedent, but ORA believes these determinations will help support the negotiations and approval of truly beneficial and fair contract restructurings.

Our current set of standards are not entirely clear; it is possible to read more than one standard regarding ratepayer benefits from the decisions cited above. Parties asked the Commission to provide clarity to our standards. However, despite considerable efforts, parties could not reach agreement on a ratepayer benefit standard. We have already stated that we will not accept the standard set forth in the settlement, largely due to the concerns articulated by ORA. Similarly, we are reluctant to adopt the standard set forth in the Draft Decision because of the opposition by the settling parties.

We will not make any changes to our current set of rules at this time. Our intention in this proceeding was to find out if a ratepayer benefit standard could be found that would enhance the ability of QFs and utilities to reach agreements, and to have such agreement provide an appropriate level of ratepayer benefits from the perspective of consumer representatives. This has not proven to be possible at this time. We are not left with no guidance at all, however; many successful restructurings have occurred under the current guidance in previous decisions.

Moreover, if a QF restructuring is unopposed, or agreed to by all parties, we often give deference to the parties' unanimous recommendations as a practical reality of the decisionmaking process, provided we believe that all affected interests are represented and the record, law, and the public interest are consistent with the unanimous recommendation. (See e.g. the Commission standard for adoption of an all-party settlement, D.92-12-019, 46 CPUC2d 538, 550-551.)

We recently adopted D.98-12-066 which adopted a modified version of a proposal for a restructuring Advice Letter process for certain QF contract modification proposals in the instances when the restructuring Advice Letter has the support or neutrality of the Office of Ratepayer Advocates. In that decision, we provided an expedited and clear path for adoption of QF contract restructurings which ORA believes do provide sufficient benefits to ratepayers.[5] These restructurings do not have to meet any particular ratepayer benefit standard. Our expectation is that that decision will open the door to more QF contract restructurings by removing perceived procedural and timeliness concerns in the industry. Therefore, the combination of the restructuring Advice Letter process and the current guidance of our past decisions should lead to more QF contract restructurings (if beneficial to the parties involved) and should not have the effect of chilling any prospective restructurings.

5. Should QF Contract Modification Negotiations Be Voluntary and Subject to Reasonableness Review?

5.1 Parties' Positions

The February 6, 1998 ruling directed that the parties address the following issue: "Should negotiations between QFs and utilities with respect to QF contract restructuring or modification be voluntary? Should utility decisions on contract restructuring or modification be subject to reasonableness review?"

All parties believe that QF contract restructuring negotiations are now, and should in the future continue to be, voluntary for both the utility and the QF. The parties differ on whether the Commission should subject a utility's actions during QF contract restructuring negotiations to reasonableness review.

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[5] Parties other than ORA have the opportunity to comment on any restructuring Advice Letter. Energy Division may recommend modification to or rejection of any restructuring Advice Letter, and may require any Advice Letter to be filed as an Application.

The Joint Utility Commenters believe the Commission should not subject a utility's restructuring decisions to any kind of reasonableness review except where an agreement has actually been reached with the QF. These parties believe that Commission reasonableness review at the pre-agreement stage undercuts the concept of voluntary negotiations, and would unnecessarily involve the Commission in the negotiation process and place the Commission in the position of micromanaging utility business decisions. The Joint Utility Commenters also cite *Racine & Laramie, Ltd. v. Department of Parks and Recreation*, 11 Cal.App.4th 1026, 14 Cal.Rptr.2d 335 (4th Dist., Div. 1 1993) and state that Commission policy endorsing the voluntary nature of contract renegotiations is consistent with California case law holding that parties to a contract do not breach the implied covenant of good faith and fair dealing by refusing to modify the contract, or by breaking off negotiations, absent an express contractual or statutory obligation to negotiate.

ORA believes that the utility's exercise of discretion regarding whether to negotiate or amend a contract is subject to reasonableness review. ORA believes that the fact that the utility has voluntary discretion to negotiate should not be a defense against claims of imprudence. Since ratepayers bear the cost of QF contracts, consistent with longstanding Commission policy, utilities are required to act reasonably and to demonstrate the reasonableness of their actions through clear and convincing evidence. For this reason, ORA argues that all utility restructuring decisions must be subject to reasonableness review.

ORA believes that exempting the utilities from reasonableness review for restructuring negotiations which do not result in a final agreement would be in conflict with the Commission's obligation to ensure rates are just and reasonable by eliminating the Commission's ability to ensure that utility negotiations with QFs are in the ratepayers' interest. ORA argues that under the utilities' proposal, a utility could avoid all risk of disallowance by refusing to agree to any restructuring proposals and by closing down their QF restructuring activities completely. Then ratepayers would lose all opportunity to reduce the competitive transition charge (CTC) through QF contract restructuring.

The QF parties argue that, although negotiations between QFs and utilities with respect to QF contract restructurings should be voluntary, if a QF approaches the utility with an offer, then the utility has the duty to negotiate in good faith. Enron cites D.82-01-103, 8 CPUC2d 20, 85, a decision addressing utility negotiations with QFs under the standard offer process, where the Commission stated that "a utility found not to have bargained in good faith will stand in violation of this order and will be open to potential punitive action by this Commission." NRG Energy believes that the Commission has established in its QF Contract Administration Guidelines Decision, D.88-10-032, that the utility must pass a reasonableness determination in any action it takes with QF contracts. However, once ORA has had an opportunity to review the reasonableness through the QFRRL or other process, NRG Energy argues that the Commission should not institute a *de novo* review of the terms and conditions of the agreement as long as no objections have been filed pursuant to the QFRRL proposal.

IEP/CCC believe that subjecting a utility to reasonableness review for its decisions on whether or not to renegotiate a QF contract restructuring opportunity is compatible with the concept that these negotiations are voluntary. They state that if a utility has made a decision that by virtue of ratepayer detriment or otherwise is not reasonable, then it is within the Commission's purview to review that decision. Watson states that the Commission needs to exercise continued oversight over a utility's contract administration activities, including continued reasonableness reviews of utility decisions on QF contract restructuring proposals. Watson is also concerned that the utilities should not use contract restructuring negotiations to restrict a QF's future competitiveness opportunities.

5.2 Discussion

All parties believe that QF contract restructuring negotiations are now, and should in the future continue to be, voluntary for both the utility and the QF. This principle is consistent with our prior decisions and we reaffirm it today. For example, in the QF Contract Administration Guidelines Decision, 29 CPUC2d at 426, we specifically stated that neither the QF nor the utility is compelled to agree to contract modifications. In a decision addressing ISO4, we recognized that in California, only the parties to the contract can change its terms. (Opinion on Guidelines for Year 11-Related Restructuring, 54 CPUC2d at 386, citing D.90-06-027, 36 CPUC2d 526, 532 (1990).)

The parties raise the separate issue of whether a utility's decisions in QF contract restructuring negotiations should be subject to reasonableness review. The Commission has the obligation to ensure that utility rates are just and reasonable. One of our many tools for carrying out this obligation is reviewing a utility's actions for reasonableness. For example, a utility must prudently administer a QF contract, and its actions in contract administration are subject to reasonableness review.

Because we want to encourage cost-effective QF contract restructurings, we do not exempt a utility's actions in QF contract restructuring negotiations from reasonableness review. This is consistent with past Commission decisions such as our QF Contract Administration Guidelines Decision, 29 CPUC2d at 427, where we reiterated "our expectations that utilities deal in good faith with the QF in all contract negotiations (see Guideline IV)." (Cf., D.83-06-109, slip op., where the Commission recognized that the question of a specific utility's compliance with the Commission's mandate to negotiate in good faith with QFs seeking nonstandard contracts was an issue in that utility's pending general rate case.) This good faith standard is the same standard of good faith that is implied in commercial contracts beyond CPUC jurisdiction. We do not believe this is the time to relax the utility's accountability to manage these costs in a reasonable manner and to do their best to reduce them whenever possible, especially when ratepayers are faced with large QF payments over the coming years.

We are also legally obligated to consider the reasonableness of the utility's negotiations as they affect competition. *Northern California Power Agency v. Public Util. Com.*, 5 Cal.3d 370, 379-381 (1971) provides that the Commission must take into account the antitrust aspects of applications before it, by a balancing test which places "the important public policy in favor of free competition in the scale along with the other rights and interests of the general public." (*Id.*) Under *Northern California Power Agency*, the Commission should undertake this obligation whether or not it is raised by a party.

> "The Commission may and should consider *sua sponte* every element of public interest affected by facilities which it is called upon to approve. It should not be necessary for any private party to rouse the Commission to perform its duty, and where a private party has so clearly demonstrated the adverse impact of the proposed facilities, the Commission certainly cannot ignore the problem simply because it was not raised by one having impeccable credentials of legal standing." (*Id.* at p. 380.)

In light of *Northern California Power Agency*, we do not believe we can exempt a utility's actions in contract restructuring negotiations from any kind of reasonableness review, especially if there is an allegation that the utility is acting anticompetitively to the detriment of ratepayers. This is especially true with new market opportunities, when the utility and the QF may be competitors in certain energy markets.

We do not believe this determination will make the Commission a party to contract restructuring negotiations, nor will we so become. We generally do not wish to be involved in reviewing negotiations absent a showing of impermissable activity by the utility that has an impact on competition and is inconsistent with the public interest.

6. Shareholder Incentive Mechanism

6.1 Parties' Positions

The February 6, 1998 ruling directed that the parties address the following issue: "How should the shareholder incentive mechanism adopted in the Commission's Preferred Policy Decision be implemented? Please discuss, inter alia, how the incentive mechanism should be calculated, tracked, and recorded."

ORA proposes that the 10% shareholder incentive mechanism, as implemented by D.96-12-077, should be eliminated or modified. Under this incentive mechanism, utility shareholders receive 10% of the ratepayer benefits from a renegotiated QF contract. ORA believes that although the Commission authorized a 10% incentive to encourage the utilities to perform beneficial contract restructurings, the incentive is skewed. ORA states that it believes the incentive is for the utility to forecast benefits for a given buyout rather than to actually deliver those benefits. According to ORA, determining ratepayer benefits to be received from a buyout is complicated and requires the exercise of judgment and speculation about future power costs. The utility is in a better position to evaluate the continuing viability and cash flow of its QF projects, and is therefore in a position to skew or overstate the benefits of the buyout.

ORA also argues that benefits are highly sensitive to forecasts of replacement costs. Insofar as the utility gains by exaggerating benefits, the forecast of replacement costs may become litigious and subject to manipulation by the utilities. However, ORA points out that replacement costs can be tracked over time and recommends that if the Commission maintains the incentive mechanism, that the shareholder incentive be based on actual, rather than forecasted savings. ORA states that the incentive mechanism should be calculated monthly, relative to actual replacement cost, to eliminate its concern discussed above.

Alternatively, ORA argues that the Commission should at a minimum, eliminate the incentive mechanism for restructurings which produce benefits during the rate freeze period, since the utility is already rewarded for such deals. ORA states that the utility, not the ratepayers, may reap all the benefits from a deal which only saves money during the rate freeze period.

TURN agrees with ORA that the 10% incentive mechanism should be based upon actual, rather than forecasted savings.

The Joint Utility Commenters believe that the shareholder incentive mechanism should be calculated as 10% of the expected ratepayer benefits at the time a renegotiated contract is signed and "trued-up" for any change in expected ratepayer benefits when the Commission approves the renegotiation. The Joint Utility Commenters state that the Commission approved this treatment for the calculation, tracking, and recording of the incentive in D.96-12-077, slip op. at p. 25. Thus, these parties believe that their recommendation is consistent with current Commission policy and prior Commission decisions.

The Joint Utility Commenter believe that the Commission should reject ORA's position because (1) a monthly true-up creates a significant administrative burden, and is contrary to the Commission's desire to streamline the QF restructuring process; (2) if a forecast is a valid means to determine the ratepayer benefits of the restructured contract, this valid means should be equally applicable to the utility to determine the amount on which the incentive is based; (3) a monthly true-up would not be simple, and the question of which calculation of actual replacement power costs to use could be litigious; and (4) if ORA believes that the utility has overstated the expected benefits of the restructuring, it has the opportunity to recommend adjustments to the utility's forecast at the time the restructuring is submitted to the Commission for approval.

Several QFs do not take a position on this issue. Of the QFs which do, IEP/CCC state that they have been suspicious of the view that contract restructuring negotiations are inhibited by the absence of a shareholder incentive. However, if the Commission determines that this incentive will enhance the restructuring, IEP/CCC believe that the incentive mechanism should be implemented in a way that adds certainty and simplicity, rather than complication, to the process.

Enron states that the Commission first endorsed the 10% shareholder incentive mechanism approach in its Preferred Policy Decision, D.95-12-063, as modified by D.96-01-009. Enron believes that this incentive has not proved effective and recommends it be increased to perhaps as high as 50%. Enron also proposes a corresponding negative incentive to the utility if it refuses to agree to reasonable proposals for restructured QF contracts.

6.2 Discussion

In our Preferred Policy Decision, D.95-12-063, as modified by D.96-01-009, we stated that when "a QF contract is renegotiated, shareholders should retain 10% of the resulting ratepayer benefits, which will be reflected by an adjustment to the CTC if the modification is approved by the Commission."

(D. 95-12-063, as modified by D.96-01-009, slip op at p. 213, Conclusion of Law 74.)

ORA's reference to changed circumstances since we made this determination does not cause us to modify it. Therefore, we retain the 10% shareholder incentive mechanism authorized by the Preferred Policy Decision.

The issue of whether the 10% incentive should be based on actual net ratepayer benefits as they accrue, rather than estimated ratepayer benefits at the time the contract is renegotiated, has not been finally decided by the Commission.

D.96-12-077, our Opinion on Cost Recovery Plans, addressed the ratemaking mechanisms for the transition period. With respect to the QF contract restructuring shareholder incentive, we stated that:

> "PG&E's draft Preliminary Statement language for this subaccount is complete and consistent with the intent of D.95-12-063. In their compliance filings, Edison and SDG&E should use PG&E's language." (D.96-12-077, slip op. at p. 25.)

However, we subsequently issued D.98-05-046, where we clarified that the Preferred Policy Decision did <u>not</u> indicate a preference for estimated net savings over actual net savings in calculating the shareholder incentive to renegotiate QF contracts, and that we did not intend to decide that issue in D.96-12-077. We further held that D.96-12-077 should be modified to so clarify, i.e. to clarify that we were not in D.96-12-077 deciding the issue of how the shareholder incentive to renegotiate QF contracts should be calculated. (See D.98-05-046, slip op. at p.5, Conclusions of Law 3 and 4.) In D.98-05-046, we stated we would address the implementation issue in this decision. (*Id.*, slip op. at p. 5.)

We adopt a shareholder incentive implementation mechanism based on the estimated net ratepayer benefits or savings because we prefer an implementation mechanism that adds certainty, simplicity, and finality to the process, rather than more complication. Also, although the estimated level of ratepayer benefits may not always correspond to actual ratepayer savings, the estimated savings or benefits could either be over- or underestimated, and thus balance out over time. Finally, because the estimated level of benefits is appropriate to use to determine whether to approve a restructured contract, that level should also be appropriate to use to determine the shareholder incentive.

The record contains PG&E's tariff filing where the shareholders receive the benefit of the 10% incentive at the time the contract is signed, subject to a true-up at the time when the Commission acts on the application to approve the restructured contract. (i.e., a debit entry of 10% of the total net present value of the ratepayer benefits from the restructured contract is made in the Qualifying Facilities Shareholder Savings Subaccount at the time the contract is signed (PG&E's tariff also provides for interest from this date); a debit or credit entry is made upon Commission approval of a restructured contract to true-up for any difference between the initial net present value of the restructured QF contract and to adjust the interest computation for the effect of the true-up.)

We permit the shareholders to receive the benefits of the 10% incentive at the time the restructured contract is signed, subject to a true-up. If any of the utilities' tariffs do not contain provisions for a true-up, the utilities should file to modify their tariffs to include true-up provisions no later than 30 days from the effective date of this decision.

We also recognize that our determination here will cause ORA to scrutinize more carefully the utilities' ratepayer benefit calculation and to oppose restructurings where it believes the estimated benefits are unrealistic. ORA's active participation should give the utilities the incentive to estimate ratepayer benefits as realistically as possible, in order to achieve ORA's approval with respect to the restructured contract.[6] Because of our determination here, we deny ORA's Petition for Modification of D.96-12-077, dated February 14, 1998.

7. SoCalGas

7.1 Parties' Positions

SoCalGas requests that the Commission adopt a policy that considers the impact of a QF restructuring on natural gas ratepayers prior to approving QF contract restructurings. SoCalGas states that judicial remedies are inadequate to protect SoCalGas' ratepayers from the harm that QF restructurings present. Therefore, in order to protect its customers, SoCalGas requests that the Commission adopt as a policy the following: (1) require all estimated benefits expected from renegotiated QF contracts to be adjusted to compensate gas ratepayers for higher gas transportation rates due to the renegotiated contract, and (2) allow SoCalGas to become an active participant in the QF contract renegotiation process of any QF that is a customer of SoCalGas.

SoCalGas explains that it transports gas to many gas-fired QF projects, and in some instances has entered into long-term transportation contracts for intrastate transmission. Depending on how the QF contracts are restructured, SoCalGas states that expected revenues from these contracts with fixed obligations may be stranded. In order to further its negotiating position with respect to the impact of a restructuring on gas ratepayers, SoCalGas

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[6] In its reply comments, ORA also raises another issue regarding the shareholder incentive which has arisen in PG&E's 1997 Energy Cost Adjustment Clause (ECAC) reasonableness review, namely, whether PG&E should be able to receive incentive awards for restructured contracts entered into during 1996, prior to the establishment of the tariff. ORA raises this issue in this proceeding for the first time on reply brief, and thus, does not afford other parties the opportunity to reply thereto. Since ORA states that this matter has arisen in PG&E's ECAC proceeding, it should be dealt with in that proceeding as appropriate.

requests that the Commission (1) order jurisdictional utilities to notify SoCalGas at the inception of any such negotiations, or immediately in the case of existing negotiations; (2) order that SoCalGas can seek discovery of all relevant studies concerning the negotiations; and order that SoCalGas be informed of the potential benefits associated with the contemplated restructured contract.

The Joint Utility Commenters oppose SoCalGas' request on four grounds. First, they state that SoCalGas has not shown that restructuring will increase the cost of transporting gas. Second, because SoCalGas is a party to the Global Settlement (approved by the Commission in D.94-04-088 and D.94-07-064), SoCalGas' shareholders, not ratepayers, are at risk for underrecovery of noncore revenue requirement throughput up to a variance cap until July 31, 1999. Moreover, the Joint Utility Commenters argue that throughput, cost allocation, and rate design will be fully addressed in SoCalGas' next biennial cost allocation proceeding (BCAP), and that its concerns can be fully addressed in the BCAP. Third, the Joint Utility Commenters argue that electric utilities and their ratepayers are not guarantors of the contracts between QFs and SoCalGas, and that SoCalGas is merely a third party contractor with various QFs. It is neither a party nor a third party beneficiary to those contracts. Fourth, these parties argue that SoCalGas' remedies against a breaching QF are adequate and there is no need for special treatment by the Commission.

ORA also objects to SoCalGas' proposal. ORA believes that requiring SoCalGas to be involved in future QF contract restructuring negotiations would unnecessarily protract such negotiations and may prevent them from coming to a closure. ORA points out that it is unclear whether, in any individual instance, a QF restructuring might affect SoCalGas' ratepayers.

ORA recommends that SoCalGas participate in applications for approval of QF restructurings and in the QFRRL process when it believes that costs to gas customers will be increased by a given restructuring. ORA explains that the mere fact that a QF contract is terminated may not be enough to demonstrate harm, since the QF may continue to operate in the competitive market, or may reimburse SoCalGas for some or all of the damages under its long-term transportation contract. Also, gas throughput at one location may be made up by increased usage at another location. ORA argues that SoCalGas has not demonstrated how its ratemaking would cause increased costs to be passed along to core customers, and believes that such a demonstration is necessary to show ratepayer harm.

The QFs who addressed this issue oppose SoCalGas. Enron believes that the Commission should reject SoCalGas' request to participate in a private negotiation to which it is not a party. Enron also believes that granting SoCalGas' request would open the door to all entities impacted by the restructured QF contract to argue that they should also be allowed to participate in the restructuring negotiations.

Watson notes that SoCalGas seeks to protect its shareholders, not ratepayers, because under the Global Settlement, the shareholders assumed for a five-year period all downside risks that revenues from noncore transportation services would fall below revenue requirements allocated to noncore customer classes. Also, shareholders assumed all risks of revenue shortfalls from discounted transportation contracts, even after the Global Settlement period. Therefore, Watson argues that ratepayers bear, at most, only limited risk for revenue shortfalls resulting from QF contract restructurings. Watson also argues that SoCalGas is not a party to the contracts, and its proposal would greatly complicate QF contract restructurings.

7.2 Discussion

We reject SoCalGas' proposal that we (1) require all estimated benefits expected from renegotiated QF contracts to be adjusted to compensate gas ratepayers for higher gas transportation rates due to the renegotiated contract, and (2) allow SoCalGas to become an active participant in the QF contract renegotiation process of any QF that is a customer of SoCalGas.

SoCalGas has not demonstrated that it is a party to the QF contracts that are the subject of this decision, nor that it has any other preferred position vis a vis this contract as compared with any other third-party contractor with the QFs. Also, whether a restructuring, in any given instance, may impact SoCalGas ratepayers at all is speculative based on this record.

Our recent decision in D.98-09-073 which approved a termination agreement of an IS04 contract between Edison and Harbor Cogeneration Company provides further explanation. Although we noted in D.98-09-073 that we did not in that proceeding prejudge the issues we address in this decision, the record here supports the result reached in D.98-09-073 that SoCalGas is not a party to standard offer contracts.

> "There is not support for the reasonable expectation that SoCal articulates in either the Public Utilities Regulatory Policies Act of 1978 (PURPA) or in our decision approving the LTK [long term transportation contract]. Title I of PURPA sets forth its purposes as the encouragement of 'conservation of energy supplied by electric utilities, (2) optimization of the efficient use of facilities and resources by electric utilities, and (3) equitable rates to electric consumers.' (Public Law 95-617, 16 USC 2601 et seq., 92 Stat. 3117.) There is no mention of any benefit or expectation to gas suppliers or any other party in the position of SoCal.
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> "In fact, we held in 1983 that standard offer contracts, such as Harbor's contract with Edison, were intended to be 'a statement of the rights and obligations of only two parties – the utility and the QF.' (D.83-10-093, 13 CPUC2d 84, 130.) This decision was in effect

at the time we approved the LTK in 1988. Had we intended to deviate from this policy at the time of approving the LTK, we would have expressly stated so. Similarly, had our approval of the LTK contemplated that SoCal would transport gas to Harbor throughout the term of the ISO4 between Edison and Harbor, we would have articulated that expectation. However, our approval of the LTK nowhere mentions the contract between Harbor and Edison and includes no reference to the term of that contract.

"In sum, we find no basis for SoCal's assumption that PURPA or Commission policy afforded it a reasonable expectation of transporting gas to Harbor throughout the term of the ISO4 contract. As discussed above, the only reasonable expectation that SoCal could have derived from Commission policy is that the Commission would not intervene to modify the LTK, once approved." (D.98-09-073, slip op. at p. 12.)

Nor has SoCalGas demonstrated on this record that ratepayers will consistently suffer harm as a result of QF contract modifications such that it is necessary to somehow require that SoCalGas be a party to the contract restructuring negotiations. In fact, in D.98-09-073, we found that SoCalGas' assertions that ratepayers will be greatly harmed by the termination agreement "are simply not supported by the record." (D.98-09-073, slip op. at p. 13.)

Thus, although we do not preclude SoCalGas (or any other party) from participating in an individual Commission proceeding requesting approval of a QF contract restructuring, or from raising any issue in the proceeding including the effect of the transaction on gas ratepayers, we reject its request to include SoCalGas' ratepayers within the "commensurate ratepayer benefit" standard, and to mandate that SoCalGas be a party to the QF contract renegotiation process of any QF that is a customer of SoCalGas.

8. Other Issues

The February 6, 1998 ruling directed that the parties address the following issue: "Set forth any other critical issues you believe necessary for the

Commission to address now in order to facilitate QF contract restructuring or modification, and Commission review thereof. Fully set forth your recommended resolution, the reasons therefore, the applicable Commission law and policy, and whether your recommendation is consistent with this law or policy or is a change therefrom."

The settlement concisely summarizes the main issues raised by the parties:

- Transitioning short-run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in Public Utilities Code Section 390;

- Other suggestions to achieve ratepayer benefits through QF contract restructurings including proposals to use securitized bonds to finance the buyout or buydown of QF contracts, divestiture of all or a portion of Edison's and PG&E's QF contract portfolios, or other such suggestions." (Settlement Agreement at p. 6.)

In addition, Watson and IEP/CCC propose that the Commission clearly instruct utilities that consideration of their own competitive position (or the competitive position of their affiliates) is an inappropriate consideration in any restructuring. The Joint Utility Commenters propose the Commission address, and reject Enron's "Motion Requesting an Order to Show Cause Against Southern California Edison Company" dated July 22, 1997, which requests that Edison justify why it did not accept Enron's proposals to sell brokered power to Edison as replacement power under five QF contracts.

We agree that it is timely and appropriate to address the issue of transitioning short-run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in PU Code § 390. Because this issue affects all electric utilities, it is best to address this issue in an all-utilities proceeding. Therefore, we direct the Coordinating Commissioner for QF issues to solicit comment from the parties on the scope of an Order Instituting Rulemaking, Order Instituting Investigation, or other appropriate proceeding regarding this issue. We anticipate that the Coordinating Commissioner will seek comments by means of an Assigned Commissioner's Ruling to issue as soon as practicable. We also encourage the parties to participate in any "participatory process" or other form of alternative dispute resolution process, in order to informally address this issue and to develop specific proposals to present for Commission approval.

We are also open to receiving other suggestions that might expedite QF contract restructuring, but do not set a specific timetable to address these suggestions. We note that Watson's and IEP/CCC's issue raised above is generally addressed in Section 5 of this decision.

Finally, we dismiss Enron's "Motion Requesting an Order to Show Cause Against Southern California Edison Company" dated July 22, 1997, without prejudice. Enron's motion requests specific Commission action against Edison with respect to its negotiations of particular QF contract. Such a motion is inappropriate in this rulemaking/investigation proceeding where we address generic issues relating to electric industry restructuring. We dismiss this motion without prejudice to Enron filing a complaint, noting that we do not prejudge whether Enron would in fact have standing to do so, or the merits of its allegations. In any such complaint, if there is a discrepancy between prior Commission decisions and today's decision, Enron's dispute should be governed by the principles adopted in today's decision.

9. Comments to the Draft Decision

On October 21, 1998, the draft decision of ALJ Econome was mailed to the parties with comments due on November 5, 1998. There were no evidentiary hearings in this matter and accordingly, the ALJ is not required to file and serve a proposed decision under PU Code § 311(d). However, as stated in a February 6, 1998 Assigned Commissioner and ALJ ruling, parties should have a brief comment period in this case, since the draft decision might address technical implementation issues, as well as policy issues, and comments within the scope of Rule 77.3 may prove useful to the Commission.

The following parties filed comments: the settling parties (jointly); ORA; SoCalGas; and Watson. Originally, we made the following changes to the draft decision in response to the comments. We clarified Section 4.2 so that the "commensurate ratepayer benefit standard" should be used for all QF contract restructuring applications (including modifications made in response to the "year-11 issue") addressed by the Commission after the effective date of this decision, as opposed to applications filed on or after the issuance of this decision. We also clarified our discussion in Section 4.2 to state that commensurate benefits should represent a reasonable, as opposed to equitable, allocation, and balancing of the benefits between ratepayers and the QF. However, after further consideration, we chose not to adopt these various changes, but instead to retain the current status of Commission pronouncements regarding ratepayer benefits We also clarify Section 4.2 to state that an inquiry into other QF financial opportunities may be appropriate in some circumstances (and thus is not mandated in every case).

We also add further elaboration in Section 5.2 regarding reasonableness review, and clarify that we generally do not want to be involved in reviewing negotiations absent a showing of anticompetitive behavior by the utility. We also change Section 6.2 to permit the shareholders to receive the benefits of the 10% incentive at the time the restructured contract is signed, subject to a true-up at the time when the Commission acts on the application to approve the restructured contract.

We add a new Section 9 to address comments to the draft decision. We have also made corresponding changes to the findings of fact, conclusions of law, and ordering paragraphs. We have also made other changes to the draft decision to improve the discussion, and to correct typographical errors.

10. Comments to the Alternate Pages

On January 6, 1999, Commissioner Neeper mailed to the parties alternate pages to the draft decision of ALJ Econome. Comments were due January 13, 1999, but were extended by ALJ Ruling to January 21, 1999. The following parties filed comments: the settling parties (jointly), ORA, and Watson. In response to these comments, the alternate pages were revised to (1) delete language in Section 4.2 regarding inquiries into future market opportunities for QFs (thus retaining the current status on this matter); (2) delete Finding of Facts 4 and 6; (3) clarify language in Section 5.2 regarding the good faith standard; (4) clarify language in Section 5.2 regarding when the Commission may review negotiations (also in Conclusion of Law 5).

Findings of Fact

1. The settling parties stress that the Commission should view the agreement as a whole, that all components of the settlement are interrelated, and that the elimination, or even rewording, of any one of the principles adopted in the settlement will render the settlement unacceptable to some or all of the parties.

2. We apply the criteria of whether the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest, to the settlement before us.

3. Although the settling parties vociferously argue that their settlement is in the ratepayers' best interest, the parties which represent the ratepayers' interests, ORA and TURN, do not support the settlement.

4. The settlement provisions which state that the utility's and QF's showing that the negotiations are ones of "arms length", and which provide for the 10%

shareholder incentive, are inadequate provisions to ensure that the resulting restructured contracts will be in the ratepayers' best interest.

5. As industries become more and more competitive, our proceedings increasingly include confidential information.

6. The settling parties oppose the Draft Decisions proposed adoption of the commensurate ratepayer benefit standard, and ORA opposes the standard in the settlement.

7. All parties believe that QF contract restructurings are now, and should in the future continue to be, voluntary for both the utility and the QF.

8. We want to encourage cost-effective QF contract restructurings. We are also legally obligated to consider the reasonableness of the utility's negotiations as they affect competition.

9. In our Preferred Policy Decision, D.95-12-063, as modified by D.96-01-009, we stated that when "a QF contract is renegotiated, shareholders should retain 10% of the resulting ratepayer benefits, which will be reflected by an adjustment to the CTC if the modification is approved by the Commission." ORA's reference to changed circumstances since we made this determination does not cause us to modify it.

10. We prefer a shareholder incentive implementation mechanism that adds certainty, simplicity, and finality to the process, rather than more complication.

11. Although the estimated level of ratepayer benefits may not always correspond to actual ratepayer benefits, the estimated benefits could either be over- or underestimated, and thus balance out over time.

12. Because the estimated level of ratepayer benefits is appropriate to use to determine whether to approve a restructured contract, that level should also be appropriate to use to determine the amount of the shareholder incentive.

13. SoCalGas has not demonstrated that it is a party to the QF contracts that are the subject of this decision, nor that it has any other preferred position vis a vis this contract as compared with any other third-party contractor with the QFs. Also, whether a restructuring, in any given instance, may impact SoCalGas ratepayers at all is speculative based on this record.

14. It is timely and appropriate to address the issue of transitioning short-run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in PU Code § 390. Because this issue affects all electric utilities, it is best to address this issue in an all-utilities proceeding.

15. Enron's "Motion Requesting an Order to Show Cause Against Southern California Edison Company" dated July 22, 1997, requests specific Commission action against Edison with respect to its negotiations of a particular QF contract. Such a motion is inappropriate in this rulemaking/investigation proceeding where we address generic issues relating to electric industry restructuring.

Conclusions of Law

1. SoCalGas' May 12, 1998 motion to file reply comments to Watson's comments, with the reply comments attached thereto, should be granted because we find no prejudice to any party in so doing.

2. The settling parties' June 10, 1998, motion proposing the adoption of a settlement agreement on QF contract restructuring and modification issues should be denied because the settlement does not adequately protect ratepayers, and thus, is not in the public interest.

3. It is not necessary to adopt a new standard of reasonableness at this time.

4. QF contract restructurings are now, and should in the future continue to be, voluntary for both the utility and the QF.

5. A utility's decisions in QF contract restructuring negotiations should be subject to reasonableness review regarding impermissable activity by the utility that has an effect on competition and is inconsistent with the public interest.

6. The 10% shareholder incentive mechanism authorized by the Preferred Policy Decision should be retained.

7. The shareholders may receive the benefits of the 10% incentive at the time the restructured contract is signed, subject to a true-up.

8. If any of the utilities' tariffs do not contain provisions for a true-up at the time when the Commission acts on the application to approve the restructured contract, the utilities should file to modify their tariffs to include true-up provisions no later than 30 days from the effective date of this decision.

9. ORA's Petition for Modification of D.96-12-077, dated February 14, 1998, which addresses the 10% shareholder incentive to renegotiate QF contracts, should be denied.

10. SoCalGas' proposal that we (1) require all estimated benefits expected from renegotiated QF contracts to be adjusted to compensate gas ratepayers for higher gas transportation rates due to the renegotiated contract, and (2) allow SoCalGas to become an active participant in the QF contract renegotiation process of any QF that is a customer of SoCalGas should be denied.

11. The Coordinating Commissioner for QF issues should solicit comment from the parties on the scope of an Order Instituting Rulemaking, Order Instituting Investigation, or other appropriate proceeding regarding the issue of transitioning short-run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in Pub. Util. Code §390. We anticipate that the Coordinating Commissioner will seek comments by means of an Assigned Commissioner's Ruling to issue as soon as practicable.

12. Enron's "Motion Requesting an Order to Show Cause Against Southern California Edison Company" dated July 22, 1997, should be dismissed without prejudice.

13. Because we want to encourage parties who wish to restructure their contracts to do so during the electric restructuring transition period, this decision should be effective immediately.

ORDER

IT IS ORDERED that:

1. Southern California Gas Company's (SoCalGas) May 12, 1998 motion to file reply comments to Watson Generation Company's comments, with the reply comments attached thereto, is granted.

2. The June 10, 1998 joint motion of Southern California Edison Company (Edison), Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Independent Energy Producers Association, California Cogeneration Council, NRG Energy, Inc., and Enron Capital & Trade Resources (Enron) proposing the adoption of a settlement agreement on qualifying facility (QF) contract restructuring, and modification issues pursuant to Rule 51.1(c) is denied.

3. QF contract restructurings are now, and shall in the future continue to be, voluntary for both the utility and the QF.

4. A utility's decisions in QF contract restructuring negotiations are subject to reasonableness review regarding anti-competitive behavior.

5. The 10% shareholder incentive mechanism authorized by the Preferred Policy Decision, Decision (D.) 95-12-063, as modified by D.96-01-009, is retained.

6. The 10% shareholder incentive to renegotiate QF contracts shall be calculated on the basis of estimated, rather than actual savings.

7. If any of the utilities' tariffs addressing the 10% shareholder incentive do not contain provisions for a true-up at the time when the Commission acts on the application to approve the restructured contract, the utilities should file to modify their tariffs to include true-up provisions no later than 30 days from the effective date of this decision.

8. The Office of Ratepayer Advocate's Petition for Modification of D.96-12-077, dated February 14, 1998, which addresses the shareholders' incentive to renegotiate QF contracts, is denied.

10. SoCalGas' proposal that we (1) require all estimated benefits expected from renegotiated QF contracts to be adjusted to compensate gas ratepayers for higher gas transportation rates due to the renegotiated contract, and (2) allow SoCalGas to become an active participant in the QF contract renegotiation process of any QF that is a customer of SoCalGas, is denied.

11. The Coordinating Commissioner for QF issues shall solicit comment from the parties on the scope of an Order Instituting Rulemaking, Order Instituting Investigation, or other appropriate proceeding regarding the issue of transitioning short-run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in Public Utilities Code § 390.

12. Enron's "Motion Requesting an Order to Show Cause Against Southern California Edison Company" dated July 22, 1997, is dismissed without prejudice.

This order is effective today.

Dated February 18, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

Attachment A

Settlement on QF Contract Restructuring
Dated As Of May 7,1998

Introduction:

Over the past several years, various parties have worked diligently to resolve differences surrounding issues of significant import to QF contract restructuring. Based on the comments recently filed in this proceeding, all parties agree on a voluntary, optional method to review proposed QF contract restructurings, called the Qualifying Facility Restructuring Reasonableness Letter ("QFRRL") process. If adopted by the Commission, the QFRRL process will result in a more efficient, streamlined procedure for review of restructured QF contracts. However, the parties were unable to reconcile their different views on the standard of reasonableness, the voluntary nature of restructurings, and the shareholder incentive.

Settlement

This document embodies a settlement agreement ("Settlement") among the California Cogeneration Council ("CCC"), Independent Energy Producers Association ("IEP"), Enron Capital & Trade Resources ("Enron"), NRG Energy Inc. ("NRG), Pacific Gas and Electric Company ("PG&E"), San Diego Gas & Electric Company ("SDG&E") and Southern California Edison Company ("Edison") (jointly, "Parties") that resolves past differences on the above issues. The Settlement constitutes a consensus "package," and therefore the Commission's failure to adopt all elements of the package will cause the Parties to withdraw their support for it. The Parties remain in agreement on the QFRRL and urge the CPUC to approve this process immediately, and also request the Commission to issue findings adopting the following settlement provisions in their entirety:

1. The Commission's standard of reasonableness for approving a QF contract restructuring should be based on a determination of ratepayer benefits under a range of reasonable economic and operating assumptions. A QF contract restructuring is reasonable and should be approved if it provides ratepayer benefits under a range of reasonable economic and operating assumptions and the benefits have been allocated through voluntary, arm's-length negotiations between utilities and QFs or their representatives.

2. QF contract restructuring negotiations are voluntary for both utilities and QFs and QF contracts may be modified only by the parties upon their mutual agreement. Although agreements to restructure QF contracts are subject to Commission review, utility restructuring decisions or actions that do not result in a restructuring agreement are not subject to reasonableness review.

3. Enron will withdraw its "Motion of Enron Capital & Trade Resources (Enron) Requesting an Order to Show Cause Against Southern California Edison Company," dated July 22, 1997.

4. The Parties agree that the shareholder incentive should be 10% of the expected ratepayer benefits as approved in D. 96-12-077. The Commission should deny the "Office of Ratepayer Advocates' Petition For Modification Of Decision No. 96-12-077" dated February 14, 1997.

5. The Parties agree that the Commission's expeditious adoption of the QFRRL process and each of the foregoing provisions will resolve issues 1-4 listed on page 3 of the Joint Assigned Commissioner's and ALJ's February 6, 1998 Ruling ("ACR"), and the Commission may therefore proceed to issue its final decision addressing those issues.

6. At the appropriate time, either this or another Commission proceeding will address:

   - Transitioning short run avoided cost energy payments to the clearing price paid by the Power Exchange as identified in Public Utilities Code Section 390;
   - Other suggestions to achieve ratepayer benefits through QF contract restructurings[1] including proposals to use securitized bonds to finance the buyout or buydown of QF contracts, divestiture of all or a portion of Edison's and PG&E's QF contract portfolios, or other such suggestions.

   In said proceeding, for the period commencing upon the effective date of this Settlement and continuing through the earlier of, a final Commission decision rejecting this Settlement or one year from the effective date of this Settlement, the Parties agree to engage in a "participatory process" wherein any Party to this document (a "Requesting Party"), prior to initiating a process at the Commission, would first provide written notice to all Parties to this document and thereafter meet with all interested Parties to discuss, on a confidential basis, regulatory proposals addressing such issues. During this process, the Parties would examine the potential for possible joint action or filings. On or after the date that is 60-days after the date of the Requesting Party's written notice (but no earlier than such date), any Party to this document may continue to pursue development of a joint regulatory proposal or proceed with a separate filing addressing any of the issues raised in the Requesting Party's written notice. The restrictions on the making of certain filings during the 60-day period described herein shall not preclude any Party to this document from responding to any Commission order or responding to any filing made by any other party. The Parties agree to utilize this participatory process prior to the issuance of a final Commission decision on this Settlement and, during such interim period, to take no actions, either directly or indirectly, that are inconsistent

[1] Thus, such items as proposals addressing items such as the Energy Reliability Index/as-available capacity payments and energy payment line-loss factors are not encompassed in this provision.

interim period, to take no actions, either directly or indirectly, that are inconsistent with the intent of this Settlement. Nothing in this Settlement shall restrict rights of the Parties to pursue judicial remedies under or concerning any QF contract.

IN WITNESS WHEREOF, the Parties hereto have caused this Settlement to be executed by their duly authorized representatives. This Settlement may be signed in multiple counterparts which, when taken together, shall constitute a single document and shall be effective as of the date first set forth above when all Parties have executed this Settlement. A facsimile signature shall be deemed an original.

Pacific Gas and Electric

By:____________________
Junona A. Jonas
Vice President, Gas & Elec. Supply

NRG Energy, Inc.

By:____________________
Ronald J. Will
Vice President
Operations and Engineering

Southern California Edison

By:____________________
Bruce C. Foster
Vice President

Independent Energy Producers Association

By:____________________
Jan Smutny-Jones
Executive Director

San Diego Gas & Electric Company

By:____________________
William L. Reed
Vice President, Regulatory & Governmental Affairs

California Cogeneration Council

By:____________________
Stacy Roscoe
Chair

Enron Capital & Trade Resources

By:____________________
David J. Parquet
Vice President

(END OF ATTACHMENT A)