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Decision 99-03-022 March 4, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the SOUTHERN CALIFORNIA EDISON COMPANY (U 338-E) for: (1) Authority to Revise its Energy Cost Adjustment Billing Factor, its California Alternate Rates for Energy, and its Base Rate Levels Effective January 1, 1994; (2) Authority to Revise the Incremental Energy Rate, the Energy Reliability Index and Avoided Capacity Cost Pricing; and (3) Review of the Reasonableness of Edison's Operations During the Period From April 1, 1992 through March 31, 1993.	Application 93-05-044 (Filed May 28, 1993)
And Related Matters.	Application 94-05-044 (Filed May 27, 1994) Application 95-05-049 (Filed May 26, 1995) Application 96-05-045 (Filed May 30, 1996) Application 97-05-050 (Filed May 30, 1997)

Frank J. Cooley, Attorney at Law, for Southern California Edison Company, applicant.
Andrew Ulmer, Attorney at Law, for the Office of Ratepayer Advocates, protestant.

OPINION

Southern California Edison Company (Edison) requests approval, in this consolidated 1993 through 1997 Energy Cost Adjustment Clause (ECAC) review, of the reasonableness of its administration of its qualifying facility (QF) contracts. The only contract administration issue disputed by the Office of Ratepayer Advocates (ORA) relates to the Arbutus pioneer QF contract. ORA recommends Edison be disallowed approximately $3.6 million, the balance remaining in the payment tracking account (PTA). For the reasons discussed, ORA's disallowance recommendation is rejected.

1. Facts

The facts which are not disputed are:

The original power purchase and sales agreement between Edison and the Arbutus Corporation, acting in its capacity as the managing agent for investors in the Pajuela Peak Wind Park, was executed in June 1983. The original agreement required Edison to pay Arbutus 8¢/kWh for capacity and energy. The difference between the payments made at this 8¢/kWh price compared to what payments would have been made based on Edison's full posted avoided cost of energy and $127/kW-yr for firm capacity, was accrued in an interest-bearing PTA. (It was expected that over the life of the contract avoided costs would exceed the payments made by Edison and the PTA would be reduced to zero.) Arbutus and its investors were required to repay the balance in the PTA to Edison. The original agreement required Arbutus to procure and maintain security satisfactory to Edison in an amount equal to the maximum balance in the PTA. In the absence of such security, Edison was to pay 95% of its avoided cost for energy and capacity instead of the 8¢/kWh. In 1984, Edison accepted a trust deed on Arbutus real property in the amount of $460,000 as security. By 1988 the posted security had increased to over $3,000,000.

As of June 1, 1988, the PTA had reached the estimated $3 million value of the security and Edison decreased its payments from 8¢/kWh to approximately 3¢/kWh, pursuant to the terms of the original contract.[1] At this same time, because Edison would not accept the project site as additional security to continue the 8¢/kWh payment, Edison and Arbutus negotiated an amended and restated contract (Renegotiated Agreement), the terms of which were designed to resolve Arbutus' difficulty in providing adequate security for the PTA. In September 1988, prior to its execution, Edison implemented the terms of the Renegotiated Agreement retroactive to June 1988. Edison and Arbutus prepared an application for approval of the Renegotiated Agreement (Application (A.) No. 89-06-022) which was filed on June 13, 1989. From June 2, 1988 until May 1990, Arbutus was paid pursuant to the terms of the Renegotiated Agreement (about 7¢/kWh) as an interim measure only, and continued payments were subject to Commission approval of the Renegotiated Agreement. However, as the application awaited Commission decision, the PTA balance continued to grow.

By letter dated May 1, 1990, while the application was pending, Edison notified Arbutus that Edison was discontinuing payments to Arbutus based on the Renegotiated Agreement. As a substitute, Edison began paying Arbutus 5¢/kWh for both energy and capacity which was the payment rate that Arbutus had earlier indicated it would require in order to continue operating for a short period.

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[1] Edison's evidence shows various values for the security in the 1988 time period. The record shows estimates of $3 million or $3.3 million or $3.9 million. What is clear is that in June 1998 the PTA balance was $3.2 million and Edison decreased its payments in accordance with its contract.

By letter dated May 17, 1990, Arbutus disputed Edison's change to the 5¢/kWh price. Arbutus demanded payment either in accordance with the Renegotiated Agreement or at the 8¢/kWh rate under the original contract. By letter dated June 4, 1990, Edison explained that it had agreed to pay Arbutus for energy and capacity based on the Renegotiated Agreement until the Commission reached its decision on the application. However, as the matter required hearings and the decision was delayed, the PTA had increased from the secured amount of $3 million to $5.4 million, and Arbutus had provided no additional security. Edison said that it could have chosen to pay Arbutus avoided cost less interest on the PTA (approximately 1.9¢/kWh) in accordance with the original contract. But, because Arbutus had previously informed Edison that a payment reduction to 1.9¢/kWh would seriously jeopardize the project, and that the project could operate for a limited period of time on payments of 5¢/kWh, Edison had decided to pay Arbutus 5¢/kWh until the Commission rendered its decision on the application. Edison believed that the revised price would serve to mitigate the rapid growth of the PTA while ensuring that sufficient revenues were provided to Arbutus to permit it to remain in operation. In letters dated June 12, and July 19, 1990, Arbutus continued to insist upon payments at either 8¢/kWh or in accordance with the payment provisions of the Renegotiated Contract. Edison responded that it intended to continue payments at the 5¢/kWh rate until the Commission issued its decision.

On November 21, 1990, we issued Decision (D.) 90-11-060 (38 CPUC 2d 317) in which we dismissed the application without prejudice. We said "Edison did not sustain its burden of showing that the renegotiated agreement was tailored to the specific financial need of the QF and that the QF would continue operations under the Proposed Agreement." (38 CPUC 2d at 330.) We encouraged the parties to negotiate a contract more tailored to Arbutus' financial needs. (Id. at 328.) However, we made it clear that any agreement would be subject to a review of the individual investors' financial statements and Arbutus' costs of operations. (Id. at 326.)

On December 7, 1990, Edison requested that Arbutus provide financial statements for Arbutus and a representative wind turbine investor. On December 17, 1990, Arbutus responded. Edison reviewed the information and found it to be inadequate. Edison requested further information. Arbutus was advised that if Edison determined that the information provided by Arbutus demonstrated the level of need which the Commission had stated was necessary, Edison would extend its best efforts to resolve the matter so that the application could be refiled in a timely manner.

After many failed attempts to obtain from Arbutus the information required by D.90-11-060, Edison realized it would not be able to file a renewed application with the Commission. At this point, Edison believed its only option was to terminate the original contract and pursue collection of the PTA. On March 29, 1991, Edison sent a letter to Arbutus terminating the original contract due to Arbutus' failure to post acceptable and adequate security for the PTA. Edison and Arbutus then executed an S01 contract to replace the original contract. The SO1 contract did not provide adequate compensation to Arbutus. In June 1991, Edison began foreclosure proceedings on the security; in July 1991, Arbutus filed for bankruptcy protection.

In the bankruptcy proceeding, all Arbutus' wind project assets were offered for sale. In addition, a majority of turbine investors were ordered to contribute to Edison a minimum of 20 percent of their proportionate share of the total PTA obligation. Edison received $0.7 million from the sale of the wind project assets and $1.1 million from settling turbine investors. Additionally, in Superior Court Arbutus was awarded in excess of $2.6 million in its breach of warranty claim against various insurance companies. Subject to appeal, Edison anticipates to receive in excess of $2.9 million from Arbutus' award.[2]

In Superior Court, Edison sued all non-settling Arbutus wind turbine investors for breach of contract relating to their failure to pay their share of the PTA balance. Edison was successful in its attempts to pursue collection from approximately 75 percent of the non-settling investors, collecting approximately $1.0 million. Thus, to date, Edison has recovered $2.8 million from the Arbutus Estate and its investors.

Further, in the bankruptcy proceeding Edison successfully defended against Arbutus' claim that Arbutus was entitled to an ISO4 contract. Arbutus had filed a complaint against Edison alleging unconstitutional impairment of contract rights; reformation of the original contract to an ISO4; damages for failing to exercise good faith and fair dealing; and damages for fraud and negligent misrepresentation. Arbutus' demand for an ISO4 contract, if granted, could have resulted in $21 million of cost to ratepayers compared to avoided cost. However, the bankruptcy court granted Edison's motion for summary judgment and dismissed Arbutus' complaint.

2. The Controversy

ORA claims that the $3.6 million balance in the PTA as of May 1998 should be disallowed because Edison acted unreasonably by permitting the PTA balance to exceed the security posted by Arbutus. Edison claims that at all times it acted

[2] On October 30, 1998 the Commission was informed by Edison that the appeal had been resolved favorably to Arbutus and that Edison expects to receive between $2.9 and $3.5 million, assuming no further appeals. (See Arbutus v. Danregn Vindkraft, Decision filed 10/28/98, Court of Appeal, 2d App. Dist., Div. 2, B 092424; not to be published in Official Reports.) It is interesting to note that the Court described the original Arbutus-Edison contract as "an unusual agreement." (Slip opinion p.2, footnote 3.)

reasonably; that the balance in the PTA is the obligation of the ratepayers; and that all money recovered in the bankruptcy and Superior Court proceedings shall be credited to the ratepayers.

In June 1988 the PTA balance was $3.2 million;

In May 1990 the balance was $5.5 million;

In March 1991 the balance was $6.3 million; and

In May 1998 the balance was $3.6 million.

The approximately $2.8 million reduction in the PTA balance resulted from Edison's recovering funds in the Superior Court and the bankruptcy proceeding. Edison expects a minimum of $2.9 million to a maximum of about $4.5 million in additional recovery. Edison would credit this additional recovery to the PTA so that under the most optimistic scenario ratepayers could benefit by almost $1 million ($4.5 million minus $3.6 million).[3]

3. ORA's Position

ORA argues that during the term of the original Arbutus agreement, Edison failed to enforce the agreement's requirement that Arbutus post adequate security. As a result in 1988, the payment tracking account balance exceeded the value of the security Arbutus had posted. Three years later, Edison terminated the original agreement. After Arbutus ceased operations and declared bankruptcy a payment tracking account balance of $6.3 million remained.[4] In ORA's opinion, Edison acted unreasonably by permitting the payment tracking account balance to exceed the security posted by Arbutus. This permission

[3] The numbers described in this opinion are close approximations and, because of rounding, appear to differ by about $100,000.

[4] Edison's efforts in the bankruptcy reduced this amount to approximately $3.6 million today.

amounted to an unsecured loan from Edison's ratepayers to Arbutus. This unsecured loan exposed ratepayers to the financial risk associated with the failure of the Arbutus wind farm. Edison's unilateral decision to expose ratepayers to this risk was unwarranted. Edison created this risk of loss through its administration of the Arbutus agreement. ORA recommends that the Commission disallow the remaining $3.6 million PTA balance associated with the original Arbutus contract.

ORA asserts that at all times Edison knew of its rights under the original contract and that on at least two occasions enforced those rights. From June 23, 1983 until June 29, 1984, Edison paid Arbutus at 95% of its avoided cost because Arbutus could not post adequate security. Again, in June 1988, Arbutus could not provide adequate security and Edison reduced payments to 95% of its avoided cost. Those actions did not violate the terms of the original Arbutus agreement; Edison understood that the terms of the original agreement required that Arbutus post adequate security to back up the PTA. Later, Edison declined to enforce those terms and permitted the PTA balance to exceed greatly the amount of security posted. For this reason, approximately $3.6 million remains in the PTA balance today. ORA concludes that it is clear that Edison's own conduct and initial reasonable administration of the Arbutus contract shows that it knew of the risks it was accepting when it permitted the PTA to exceed the security and failed to reduce payments in accordance with the terms of the original contract. This was unreasonable administration, according to ORA.

ORA maintains that Commission decisions issued before the Arbutus contract was signed put utilities on notice that QF contracts were not to burden ratepayers. ORA cites D.82-01-103 (8 CPUC 2d 20), regarding electric utility purchases of energy from cogeneration and small power production facilities, for the proposition that ratepayers should not bear the burden of all QF risks. The

Commission addressed preapproval of nonstandard contracts via the application process and stated:

> "We must caution all parties that the Commission will review these contracts as a banker reviews a loan application, with scrutiny and skepticism. While we want to encourage QF development, we do not wish to burden ratepayers in the process." (8 CPUC 2d at 83.)

In D.82-04-087 (8 CPUC 2d 673), the Commission approved a non-standard contract between Pacific Gas and Electric Company (PG&E) and U.S. Windpower, which contained similar provisions to the agreement between Edison and Arbutus. The Commission determined that ratepayers were adequately protected against any potential risk because the appraised salvage value of U.S. Windpower's wind farm was sufficient to cover all probable losses to ratepayers or the utility if the project failed during the early years of that contract. (8 CPUC 2d at 685, Finding of Fact No. 4.) In a concurrence to D.82-04-087, Commissioners Gravelle and Grimes stated:

> "While there will be instances such as this where ratepayers can benefit by <u>sharing</u> QF project risk, in general we feel that it is more appropriate for the utilities (or other investors) to share risks and benefits with QFs in cases where QFs seek to spread project risks to facilitate financing. Utilities are in a better position to evaluate the technical risk associated with a particular project than are regulators. Utilities are thus capable of making more fully informed judgments as to when it is desirable to participate in the unregulated risks and returns of the QF market." (8 CPUC 2d at 686 emphasis added.)

The Commission issued those decisions before Edison executed its agreement with Arbutus in 1983. The Arbutus agreement, much like the U.S. Windpower non-standard contract, contained certain risks if the project failed during the early years of operation. However, the security required by the Arbutus agreement to back up the PTA provided adequate protection to Edison's customers. ORA contends that once Edison decided to forgo the requirement of additional security for the PTA despite its continued growth, Edison's customers faced exposure in the event that the Arbutus project failed. Edison created this exposure by its unreasonable action of implementing the terms of the proposed Renegotiated Agreement without requiring additional security to back up the growing PTA balance. Edison knew or should have known such action was unreasonable. Furthermore, by not requiring additional security when the PTA balance exceeded the posted security, Edison, by ORA's reasoning, decided to guarantee a debt Arbutus owed to Edison's ratepayers.

4. Edison's Position

Edison believes that it acted reasonably in its dealings with Arbutus, just as Commission policy required. It explains that two and one-half months after Arbutus entered its contract with Edison, the Commission approved the Interim Standard Offer 4 (ISO4) contract (D.83-09-054, 12 CPUC 2d 604, 609). Despite earlier pronouncements by the Commission that a long-term standard offer contract would be made available to QFs who had already signed a non-standard contract (such as Arbutus) (D.82-01-103, 8 CPUC 2d 20, 110; D.82-12-120, 10 CPUC 2d 553, 628), the Commission refused to allow these pioneer QFs[5] to switch to the ISO4 contract (12 CPUC 2d at 616). The lucrative provisions of the ISO4 contract eventually led to its oversubscription. The resulting over-capacity reduced the need for new electric generation resources and contributed to a substantial and unexpected decline in energy and capacity prices. These events drastically affected the economics of the Arbutus project. The Commission recognized the dire situation faced by pioneer QFs such as Arbutus and ordered

[5] A pioneer QF is a QF that entered into a generation contract prior to the Commission's adopting interim SO4 on September 7, 1983 (23 CPUC 2d 499, 501, 503 footnote 1).

Edison and PG&E to offer to renegotiate these contracts to preserve the long-term value of these projects (D.87-01-049, 23 CPUC 2d 499, 501).

D.87-01-049 resulted from the application of the Independent Energy Producers (IEP) seeking permission for pioneer QFs to switch to the ISO4 contract. There, IEP argued that the Commission sought to encourage early development of QFs by providing them an option to switch to the final standard offer contract when it became available. IEP maintained that the Commission violated its commitment to QF developers who signed non-standard contracts prior to the availability of the ISO4 contract.

While acknowledging the merit of IEP's position, the Commission declined to adopt it. Instead, the Commission ordered Edison and PG&E to report on the progress achieved in negotiating agreements with pioneer QFs to preserve the benefit of those projects for utility customers. The Commission concluded:

> "Our decision to postpone further Commission action to allow time for negotiation does not indicate a lack of concern for the problems of pioneer QFs. Indeed, the potential of negotiated settlements to tailor relief more appropriately to the needs of specific projects is one of the reasons we prefer seeking negotiated agreements. <u>We are also concerned, however, that relief be provided in a timely manner</u>." (D.87-01-049, 23 CPUC 2d at 502; emphasis added.)

The Commission's mandate was clear, in Edison's opinion. PG&E and Edison were to negotiate with pioneer QFs who desired a replacement contract to address their worsening financial situation. The goal of the negotiations was to insulate the pioneer QFs to some degree from the effects of later QF development on pioneer QF energy prices.

Under the PTA, Arbutus effectively bore the full risk of the decline in energy and capacity prices. As avoided costs declined, the PTA balance grew and by mid-1988 Arbutus was reaching the limits of its ability to provide adequate security for the PTA. Arbutus then approached Edison seeking to renegotiate its contract in accordance with the Commission's policy announced in D.87-01-049.

Entering the negotiations with Edison, Arbutus claimed it was entitled to an ISO4 contract. This claim was taken seriously by Edison. Agreement in principle was reached between Edison and Arbutus in September 1988. Arbutus would receive a contract that (i) would allow Arbutus to continue to operate, (ii) would eliminate the financial burden of the accrued PTA balance, and (iii) would permanently resolve Arbutus' claim to an ISO4 contract. An amended contract, based on the principles agreed to in September 1988, was finalized in May 1989 (the Renegotiated Agreement).

Edison insisted on Commission review and approval of the Renegotiated Agreement, but agreed to begin making payments based on the agreement pending Commission approval to prevent the immediate bankruptcy by Arbutus. An application was filed shortly thereafter. Eighteen months later, in November 1990, that application was dismissed (D.90-11-060, 38 CPUC 2d 317); prior to that, in May 1990, Edison had refused further payments under the Renegotiated Agreement and paid 5¢ kWh; in March 1991, Edison terminated the original contract; Edison and Arbutus entered into an SOI contract; and shortly thereafter Arbutus declared bankruptcy.

5. Discussion

If we review Edison's actions in its contractual relations with Arbutus "as a banker reviews a loan application" (D.82-01-103, 8 CPUC 2d at 83) we would find that Edison administered the original contract in an unreasonable manner and is liable for the current balance in the PTA. Edison, having invoked the terms of its contract in the summer of 1988 and paid Arbutus 95% of avoided costs, should have maintained that position until the Commission authorized a different contractual arrangement. Under those circumstances Edison should not have paid Arbutus in accordance with Renegotiated Agreement as if it had been approved by the Commission. Had Edison adopted this posture, undoubtedly Arbutus would have declared bankruptcy sometime in late 1988, the PTA would have risen to about $3.4 million, and the security probably would have been adequate to cover the PTA. There would be no disallowance.

However, D.82-01-103 must be read in light of the gloss of other contemporary decisions. From Edison's point of view, failure to pay under the Renegotiated Agreement could have had damaging consequences. First, assuredly Edison would have been subject to litigation by Arbutus alleging failure to negotiate in good faith. Second, Edison's having already been fined $8 million by this Commission (D.82-12-055, 10 CPUC 2d 155, 258) for failure to negotiate in good faith in prior QF litigation, gave rise to the distinct probability that it might be fined again. Third, and perhaps most important, Edison knew the Commission policy regarding encouraging QFs. We had stated at the time we fined Edison $8 million that Edison's effort to obtain lower costs for its customers "had a chilling effect on the development of QF resources" (10 CPUC 2d at 331) in violation of the Commission's policy in favor of "utility encouragement of cogeneration and other alternative and renewable resources...." (Id. at 255.) We emphasized that Edison had a duty "to exercise its best efforts to pursue and develop cogeneration and SPP [small power production] resources using avoided cost principles." (Id at 257).

Prior to that decision we had warned utilities that we would

> "entertain formal complaints raised by QFs who can demonstrate that the utility has failed to bargain in good faith. Such complaints from QFs shall be treated expeditiously by staff, and where hearings are necessary, hearings shall be set promptly....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." (D.82-01-103, 8 CPUC 2d 20, 85.)

D.87-01-049 (23 CPUC 2d 499) is particularly instructive. In 1986, IEP requested that the Commission permit pioneer QFs the opportunity to switch to ISO4 payments. IEP argued that the longer-than-anticipated lapse between the adoption of interim Standard Offer 4 and the adoption of a final long-run offer should lead the Commission to reconsider its ban on contract switching (which had occured in D.83-09-054, 12 CPUC 2d 604). In IEP's view, the pioneers had been unfairly disadvantaged by the substantial amount of capacity coming on line under ISO4. This later QF capacity had the effect of depressing energy prices paid to pioneer QFs at a time when a precipitous drop in oil and gas prices already had caused their energy payments to plummet. According to IEP, many pioneer QFs were receiving payments insufficient to meet their debt service obligations. This dramatic decrease in energy payments, IEP believed, could not have been foreseen by a prudent manager at the time those early contracts were signed.

IEP said the result of this drop in energy payments could force many pioneer QFs to cease generation or to go out of business entirely. IEP believed that such an outcome was not in the best interest of California's ratepayers or the California economy as a whole. Therefore, IEP requested that the Commission grant the pioneers the option to switch to ISO4 or some variation thereof.

Edison opposed IEP's request. It argued, first, at the time they entered into their contracts, pioneer QFs knowingly accepted certain risks with respect to future Commission-developed contracts and prices. Second, permitting pioneer QFs to switch to ISO4 would be prohibitively costly to Edison's ratepayers. Edison would limit any relief to those QFs with clauses in their contracts allowing them to switch to the final long-run offer.

Although we rejected IEP's request, we found cause to be concerned. We said:

> "Given the conditions under which this Commission initiated the QF program, we find IEP's assertions regarding the expectations of pioneer QFs plausible. Many pioneers made the decision to enter into early contracts only because they believed this Commission implicitly or explicitly assured them of the right to convert to a final long-run offer once such an offer was adopted. Such expectations were a reasonable reading of the Commission's orders and statements regarding the QF program; it has always been the Commission's intention that those who answered the call when QF energy was most urgently needed would be appropriately compensated for the risks they undertook."
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> "Balancing the claims of pioneer QFs against the potential for overpayments is difficult. None of the parties in this matter have offered us a viable middle ground. At this time, the suggestion of PG&E and Edison to attempt negotiated settlements with pioneer QFs appears to have the greatest potential for preserving the benefit of the pioneers' contribution to the reliability of the utility systems without unduly burdening ratepayers with increased payment exposure." (23 CPUC 2d at 501-502.)

We specifically rejected Edison's proposal to limit relief to those QFs with contractual rights to switch to standard offers. We said :

> "QFs that had the opportunity to switch to interim Standard Offer 4 should be precluded from any relief from the terms of their existing contracts." (23 CPUC 2d at 503, Con. of Law 4.)

We postponed further Commission action to allow time for negotiation and we ordered the utilities to write a report to us detailing the progress achieved in negotiating agreements with individual pioneer QFs. (Id. at 502.)

In D.87-01-049 we recognized the difficult situation facing pioneer QFs. However, we refused to impose a solution finding that "[n]one of the parties in this matter have offered us a viable middle ground." (23 CPUC 2d at 502.) We encouraged Edison and PG&E to negotiate settlements with pioneer QFs "to tailor relief more appropriately to the needs of specific projects, ..."and we were concerned "that relief be provided in a timely manner." (Id. at 502.) Edison contends that its negotiations with Arbutus complied with the Commission's directive.

ORA takes a narrower view of D.87-01-049. It says the Commission did not require Edison to renegotiate any contracts. Rather, the Commission took notice of the suggestion by Edison and PG&E that negotiated settlements with pioneer QFs were appropriate. (23 CPUC 2d at 502.) ORA asserts that the Commission did not provide license to Edison to renegotiate contracts so as to expose ratepayers to increased financial risk. In fact, in D.87-01-049, the Commission said:

> "At this time, the suggestion of PG&E and Edison to attempt negotiated settlements with pioneer QFs appears to have the greatest potential for preserving the benefit of the pioneers' contribution to the reliability of the utility systems <u>without unduly burdening ratepayers with increased payment exposure."</u> *Id*; Emphasis added.

ORA points out that Edison forgave a large portion of the PTA balance in its Renegotiated Agreement despite the Commission's admonition that utilities should not unduly burden ratepayers with increased payment exposure. Moreover, Edison continued to allow the PTA balance to grow unsecured during the term of the original contract. Those actions created increased payment exposure for Edison's ratepayers and thus violated the intent behind D.87-01-049. ORA argues that Edison has mischaracterized D.87-01-049 to obtain a favorable result in this case; this does not change the fact that Edison exposed its ratepayers to unnecessary financial risk by allowing the PTA balance to outgrow the security posted by Arbutus.

ORA has, in our opinion, too narrowly construed our policy in this area. We cannot review QF contracts without taking cognizance of the environment in which they were nurtured. In our recent D.98-09-040 we considered other

Edison-QF contracts where ORA had sought disallowances. In that decision, in upholding the reasonableness of Edison's contract administration, we reviewed our history of encouraging alternate sources of electricity and the emphasis we placed on supporting the nascent QF industry. We were encouraging new projects and expected utilities to vigorously pursue their QF development programs. (D.84-12-068, 16 CPUC 2d 721, 845.) While acknowledging and condoning above-market rates being paid QFs, we expected continued good faith negotiations and renegotiations by utilities with QFs. (D.85-04-075, 17 CPUC 2d 521, 529; D.87-01-049, 23 CPUC 2d 499.)

We agree with Edison's contention that had Edison reduced payments to Arbutus as recommended by ORA, it would have violated the Commission's express directive to utilities to provide "timely relief" to pioneer QFs such as Arbutus. Arbutus sought an amended contract when it became clear that as a result of declining avoided costs, the PTA balance would exceed the value of security it could provide to Edison. Had Edison responded to Arbutus' overture by reducing payments, Arbutus would have been forced into certain bankruptcy. It is unreasonable to believe that this result could constitute compliance with Commission decisions recommending renegotiation of pioneer QF contracts to assure their continued operation.

As an adjunct to its contract administration, Edison pursued recovery from Arbutus and its investors in both the Superior Court and the bankruptcy court. To date Edison has recovered $2.8 million with the expectation of an additional $2.9 million, if not more; all to be credited to the ratepayers. Edison is to be commended for its efforts.

6. Decision 98-04-023

In A.91-05-050 we reviewed the reasonableness of Edison's contract with the Mojave Cogeneration Company and found Edison's contract administration to be unreasonable. (Findings of Fact 16, Conclusion of Law 1, D.98-04-023 mimeo., pp. 23-24.) As a result we ordered Edison to credit its Electric Deferred Refund Account (EDRA) in the amount of $46,000 plus interest for the record year April 1, 1990 through March 31, 1991. (Id. p. 24.) In this current review of Edison's administration of its QF contracts the parties by stipulation have updated the Mojave contract disallowance through the 1997 ECAC record period. The result is a further disallowance of $16.3 million to be credited to EDRA. The details are in the Findings of Fact.

7. Comments

This decision was issued as a Proposed Decision to which the parties filed comments. ORA's argument that the facts do not support the result is merely rearguing its case and is not persuasive. More substantively, ORA argues that the bankruptcy recovery, which could reach $4.5 million, should be returned to the ratepayers via a credit to the EDRA. This account actually sends cash or credits to the ratepayers. Edison, to the contrary, argues that the bankruptcy recovery be a credit to the Transition Cost Balancing Account (TCBA), where it will offset Edison's transition costs and could shorten the rate freeze. Edison believes a credit to the EDRA is wrong and contrary to Commission policy and practice. It says the EDRA was established to return to customers disallowances ordered by the Commission. The proposed decision finds Edison's actions reasonable and does not order a disallowance. Therefore, the amounts recovered from the Arbutus estate should, for ratemaking purposes, be credited to the TCBA. Edison says this ratemaking treatment is consistent with Commission decisions regarding recoveries under QF contracts. (D.97-11-064, mimeo., p. 9, (QF contract settlement credited to TCBA), __ CPUC2d ___, 1997; D.98-06-069, mimeo., p. 3, (QF contract settlement credited to TCBA), __ CPUC2d ___, 1998.)

ORA counters that if Edison's ratepayers are to receive money from the Arbutus bankruptcy, it is necessary to implement a recovery mechanism. Allowing Edison to credit the TCBA does not ensure that Edison's ratepayers will recover these funds because the funds may accrue to Edison's shareholders in the event that the rate freeze does not end early. To prevent this, ORA urges us to specify a credit to the EDRA.

We agree with Edison. There is a difference between a disallowance, which is refunded to ratepayers, and the collection of a debt, as the Arbutus debt, which should be a credit to the TCBA. There is nothing out-of-the-ordinary in the Arbutus contract dispute that requires special treatment as a refund.

Findings of Fact

1. Edison executed a 30-year non-standard contract with Arbutus, a pioneer QF, on June 22, 1983.

2. The original Arbutus contract was executed two and one-half months before the Commission approved the ISO4 contract in D.83-09-054.

3. The Commission in D.83-09-054 precluded QFs who had signed non-standard contracts from switching to the ISO4 contract.

4. The original Arbutus contract provided a price floor of 8¢/kWh and tracked the difference between payments to Arbutus and actual avoided cost.

5. Under the original Arbutus contract, Arbutus was required to provide security in an amount equal to the anticipated PTA balance for the coming year and maintain the security as long as there was, or was expected to be, a balance in the PTA. In the absences of such security, Edison would pay 95% of its avoided cost.

6. Under the original Arbutus contract, Arbutus and its investors bore the full risk of a decline in energy and capacity prices.

7. In D.87-01-049, the Commission concluded pioneer QFs should receive some relief from the decline in avoided cost pricing. The Commission found that pioneer QFs had been encouraged to enter into non-standard contracts prior to the availability of ISO4 and they had been disadvantaged by delays in the availability of Final Standard Offer 4 contracts.

8. In D.87-01-049, the Commission again denied pioneer QFs the opportunity to switch to ISO4 contracts.

9. In D.87-01-049, the Commission encouraged Edison to negotiate contract amendments and settlements with pioneer QFs who requested relief to address their worsening financial situation.

10. The Commission's policy with respect to renegotiated contracts with pioneer QFs was to preserve the long-term value of these projects without unduly burdening ratepayers with increased payment exposure.

11. In June 1988, Arbutus' PTA balance exceeded the level of posted security and Edison reduced payments to 95% of Edison's avoided cost pursuant to the original contract.

12. In response to Arbutus' request in 1988 to renegotiate its non-standard contract, Edison entered negotiations with Arbutus.

13. During negotiations Arbutus insisted that it was entitled to an ISO4 contract.

14. By September 1988, Arbutus' PTA balance had grown to approximately $3.3 million.

15. In September 1988, Arbutus provided an open-ended deed of trust with an estimated value of $3.9 million as security for the PTA balance.

16. In September 1988, Edison and Arbutus reached agreement in principle regarding the terms of a Renegotiated Agreement.

17. To prevent Arbutus from filing for bankruptcy protection, beginning in September 1988, Edison paid Arbutus in accordance with the terms of the unexecuted Renegotiated Agreement retroactive to June 1988.

18. If Edison had continued to pay Arbutus avoided cost or 95% of avoided cost in 1988, the likely result would have been to force Arbutus immediately to declare bankruptcy.

19. On May 9, 1989, Edison executed the Renegotiated Agreement with Arbutus. The Renegotiated Agreement was implemented before its execution.

20. A condition precedent to the Renegotiated Agreement was that it would not be in effect unless the Commission issued an order finding the contract reasonable and that Edison's entering into the agreement was prudent and authorizing recovery of payments by Edison through rates.

21. On June 9, 1989, Edison filed an application seeking expedited approval of the Renegotiated Agreement.

22. Eighteen months after Edison filed its application for approval of the Renegotiated Agreement, the Commission issued D.90-11-060 which denied approval without prejudice on the ground that Edison had not demonstrated that the Renegotiated Agreement was tailored to the specific financial needs of Arbutus.

23. After D.90-11-060 was issued, Edison entered discussions with Arbutus seeking the information the Commission had requested regarding Arbutus' financial condition.

24. After four months of discussions, Edison concluded Arbutus was not able or was unwilling to provide the information the Commission had requested.

25. In March 1991, Edison terminated the original Arbutus contract and entered a Standard Offer 1 contract with Arbutus.

26. On March 29, 1991, the amount of the PTA balance was $6,291,695.25.

27. On March 29, 1991, the amount of security provided by Arbutus was estimated at $3.9 million.

28. In June 1991, Edison filed a civil complaint in the Kern County Superior Court seeking foreclosure of Arbutus' interest in the wind project and a judgment against Arbutus and its investors for any shortfall after the foreclosed property was sold to recover the PTA balance.

29. In July 1991 Arbutus declared bankruptcy.

30. In the bankruptcy proceeding Arbutus claimed it was entitled to an ISO4 contract.

31. If Arbutus had been successful in its claim that it was entitled to an ISO4 contract, Edison's ratepayers would have paid $21 million more than avoided cost.

32. Edison defeated Arbutus' claim that it was entitled to an ISO4 contract.

33. To date Edison's ratepayers have received approximately $2.8 million in proceeds from the bankruptcy proceeding.

34. If the matters currently under appeal are resolved in favor of Arbutus the outstanding PTA balance of $3.6 million could be fully recovered.

35. Edison acted reasonably on behalf of its ratepayers in the bankruptcy proceeding.

36. Edison's administration of the Arbutus contract was reasonable.

37. Edison's ratepayers are entitled to recover the proceeds from the Arbutus bankruptcy proceeding.

38. In the reasonableness phase of Edison's ECAC in A. 91-05-050, for the record period April 1, 1990 through March 31, 1991, we found that Edison had acted unreasonably in executing a contract involving the Mojave Cogeneration Project. We disallowed $46,000 for the record period. (D.98-04-023.)

39. The disallowance amounts related to the Mojave contract for the 1992 through 1997 record period are as follows:

Record Period		Disallowance
1992		$4,692,000
1993		$3,518,000
1994		$3,303,000
1995		$2,802,000
1996		$2,163,000
1997		$1,492,000
	Total:	$17,970,000

40. The total disallowance of $17.97 million through the 1997 ECAC record period exceeds the $16.3 million disallowance the Commission ordered in D.98-04-023 over the life of the Mojave contract.

41. The Commission's disallowance in D.98-04-023 created a proxy contract for the Mojave project that is the measure of what is reasonable for Edison to recover for ratemaking purposes.

42. In the early years of the Mojave contract when compared to the proxy Mojave contract, there are undercollections in ECAC balancing account compared to the amount paid to the Mojave project.

43. In the later years of the Mojave contract when compared to the proxy Mojave contract, there are overcollections in the ECAC balancing account compared to the amount paid to the Mojave project.

44. The net present value of the undercollections in the early years and the overcollections in the later years equal the net present value disallowance of $16.3 million.

45. ORA agrees that Edison is entitled to retain the later years' overcollections to the extent they exceed $16.3 million because Edison assumed responsibility for the early years' undercollections under D.98-04-023.

46. There are no other issues raised by ORA in A.93-05-044, A.94-54-044, A.95-05-049, A.96-05-045, and A.97-05-050 and these proceedings should be closed, subject to being reopened for the limited purpose of considering issues related to the Coso projects as provided in D.98-09-040.

Conclusions of Law

1. The Commission approved the reasonableness of the original Arbutus contract in D.93-04-006.
2. The Commission approved the reasonableness of Edison's administration of the original Arbutus contract during the period December 1, 1984 through March 31, 1990 in D.93-04-006.
3. In D.87-01-049, the Commission encouraged Edison to negotiate replacement contracts with pioneer QFs who requested them.
4. Edison's administration of the Arbutus contract was reasonable.
5. Edison shall credit any recovery from the Arbutus bankruptcy to its TCBA.
6. A.93-05-044, A.94-05-044, A.95-05-049, A.96-05-045, and A.97-05-050 should be closed, subject to being reopened for the limited purpose of considering issues related to the Coso projects as provided in D.98-09-040, Conclusion of Law 21.

O R D E R

IT IS ORDERED that:

1. In compliance with Decision (D.) 98-04-023, Southern California Edison Company (Edison) shall credit its Electric Deferred Refund Account (EDRA) in the amount of $16.3 million, plus applicable interest, within 30 calendar days after the effective date of this order. Edison shall submit an Advice Letter within 30 calendar days after the effective date of this order which sets forth a plan to refund these amounts to ratepayers within 60 days following the submittal.

2. Interest on the $16.3 million to be credited to the EDRA shall accrue at the rate earned on prime, three-month commercial paper, as reported in the Federal Reserve Statistical release, G.13, until such amounts are refunded to Edison's ratepayers.

3. Edison shall credit any recovery from the Arbutus bankruptcy to its Transition Cost Balancing Account.

4. Application (A.) 93-05-044, A.94-05-044, A.95-05-049, A.96-05-045, and A.97-05-050 are closed, subject to being reopened for the limited purpose of considering issues related to the Coso projects as provided in D.98-09-040, Conclusion of Law 21.

This order is effective today.

Dated March 4, 1999, at San Francisco, California.

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