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Decision 99-08-008 August 5, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) for Order Approving Agreements Restructuring the Negotiated Power Purchase Agreement Between Southern California Edison Company and AES Placerita, Inc.	Application 99-05-006 (Filed May 5, 1999)

OPINION

Summary

We approve Southern California Edison Company's (SCE) proposed buyout of a 1984 power purchase agreement with AES Placerita, Inc. (AES), a qualifying facility (QF).[1] Expected ratepayer benefit from the buyout is $32.5 million net present value (NPV) and the shareholder incentive reward for negotiating the buyout is $3.25 million.

Procedural Summary

In Resolution ALJ 176-3015 dated May 13, 1999, the Commission preliminarily categorized this application as ratesetting and determined that hearings were necessary.

SCE seeks expedited, ex parte approval of the application. The Office of Ratepayer Advocates (ORA) filed comments in support of the application, but

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

raised concerns over the calculation of expected ratepayer benefits. Likewise, Southern California Gas Company (SoCalGas) filed responses in support of the application. The responses of ORA and SoCalGas are discussed below.

A Scoping Memo and Ruling of the Assigned Commissioner was issued on June 25, 1999. Assigned Commissioner Neeper ruled that: (1) this proceeding should be categorized as ratesetting; (2) no hearings were necessary since there were no disputed issues of material fact; and (3) this proceeding should be submitted for decision based on the comments filed by the parties.

We affirm Commissioner Neeper's ruling.

The Application

AES is a cogeneration facility located in Newhall, California. On November 14, 1984, SCE and AES executed a 25-year negotiated power purchase contract. It originally provided for SCE to purchase from AES 98.7 MW of firm capacity and associated energy. After subsequent amendments, the contract requires SCE to purchase from AES 98.7 MW of base contract capacity and 11.3 MW of supplemental contract capacity and associated energy.

The contract's negotiated terms require SCE to pay substantially higher rates than its current and reasonably foreseeable future replacement costs for approximately equivalent amounts of power. Therefore, SCE negotiated a restructuring of the contract that will result in substantial savings to SCE's customers, compared to continued performance under the contract.

Specifically, SCE, AES, and a third party, Citizens Power LLC (Citizens), entered into a series of agreements that will terminate altogether SCE's obligation to purchase power from AES under the contract. Under one set of agreements, for which Commission approval is not sought in this application because SCE is not a party thereto, AES will assign its prospective rights and

obligations under the existing contract to Citizens, in exchange for a lump sum payment from Citizens. Another set of agreements that will complete the contract restructuring, and for which Commission approval is sought by this application, are primarily between SCE and Citizens.

According to SCE, the restructuring agreement will result in total expected benefits to SCE's ratepayers ranging from $33.6 million to $46.1 million (NPV). These savings result from the replacement of AES' capacity with lower-priced capacity from alternate sources, taking into account the termination payments to be paid to Citizens. At a minimum, SCE expects a net ratepayer benefit of $20.4 million (NPV).

Motion for Protective Order

SCE requested a protective order covering certain information submitted in support of its application. Specifically, SCE requested that the Commission keep under seal: (i) the restructuring agreements' specific terms; (ii) SCE's model for and analysis of customer benefits from the contract termination, including the discount rate and date of net present value used in deriving the benefits; (iii) SCE's analysis of AES' economic viability; (iv) SCE's experts' analysis of AES' technical viability; and (v) SCE's experts' analysis of the viability of an alternative steam host, Placerita Oil Company, Inc. and SCE's own analysis of AES' actual steam host, Berry Petroleum Company (Berry).

In a ruling dated June 1, 1999, the assigned administrative law judge (ALJ) granted SCE's motion substantially as requested. We affirm the ruling.

Position of ORA and SCE

ORA supports the restructuring agreements as negotiated by SCE. However, ORA disagrees with SCE's estimate of ratepayer savings ranging from

$33.6 million to $46.1 million NPV and SCE's request for a shareholder incentive reward of $4.6 million for negotiating the restructuring agreements.[2]

In response to SCE's application, ORA raised certain issues related to Energy Line Adjustment Factors (ELAFs). ORA identified the difference between the use of an ELAF and a Generator Meter Multiplier (GMM) for purposes of tracking energy losses given the current market structure associated with various metering points as determined by the Independent System Operator. ORA also raised certain issues concerning Reliability Must Run contracts associated with the proposed termination.

SCE does not agree with the concerns raised by ORA. However, in the interest of reaching an expedited resolution of their differences, SCE and ORA agreed to reduce the expected ratepayer benefit stated in the application. SCE and ORA agreed that a more appropriate statement of the net ratepayer benefit under an expected case scenario is $32.5 million. Accordingly, SCE and ORA agreed that an appropriate shareholder incentive reward for negotiating the termination agreement would be $3.25 million. ORA considers an expected ratepayer benefit of $32.5 million to be sufficiently robust under a range of economical and operational assumptions to satisfy the commensurate ratepayer benefit standard given the projected benefits of the termination to AES and SCE.

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[2] See *In Re Proposed Policies Governing Restructuring California's Electric Services Industry and Reforming Regulation*, D.95-12-063, 64 CPUC2d 1, 64-65 (1995); as modified by D.96-01-009, mimeo., p. 132, wherein the Commission decided that a utility should be permitted to retain 10% of the savings when it restructures and reduces the cost of a QF contract. See also D.99-02-085, mimeo., at p. 29.

Project Performance and Viability

AES sells electricity to SCE, and steam from the waste heat to its neighbor, Berry. Berry leases oil fields and uses the steam for an Enhanced Oil Recovery (EOR) process. The generating facility consists of two combustion gas turbine-generator units in conjunction with a steam turbine-generator unit, that form a combined cycle facility with a nameplate rating of 110 MW. The AES project is designed to operate 24 hours per day. It achieved firm operation on August 29, 1988. Since 1994, the generating facility has performed consistently at an average capacity factor of 76.4%, based on a contract capacity of 98.7 MW and net of the contract's annual dispatch provisions.

SCE investigated the project's steam host, Berry, to establish that it would continue to use steam from AES for the remainder of the original contract term. (Federal Energy Regulatory Commission (FERC) rules require that, in order to maintain qualifying facility status, a project must have a steam host that accepts a certain amount of steam). Also, to verify its own informal analyses of AES' viability and future operations as a cogeneration facility, SCE retained both Energy Options, Inc. (Energy Options) and Duke Engineering and Services (Duke Engineering), third-party consultants with expertise in energy plants and oil fields.

Energy Options examined four major areas: (i) expected plant performance, (ii) capital cost estimate, (iii) operating and maintenance cost estimate, and (iv) thermal sales. Energy Options concluded that the project is technically sound and capable of operating at its designed output over the remainder of the contract term.

Duke Engineering evaluated the suitability of the Placerita Oil Company, Inc. (POCI) oil leases to serve as an alternative host. The POCI oil leases are on property contiguous to the project; both the generating facility and the POCI oil

leases are wholly owned by AES' parent, AES Corporation. Duke Engineering investigated the feasibility of the oil leases to: (i) accept the volume of steam required to qualify as a steam host under FERC regulations and (ii) determine the amount of oil which could be recovered from the oil leases. Duke Engineering determined that it would be economic for POCI to accept the necessary steam and continue producing oil for the duration of the contract, and that POCI is a viable alternative host for AES.

Based on the foregoing, and upon the fact that AES has restored both gas turbines at the project to "new and clean" condition within the past two years, SCE is of the opinion that the project is capable of maintaining its high level of output, and will remain technically viable for the remainder of the contract term.

Discussion

The Commission scrutinizes the reasonableness of buyouts on a case-by-case basis. We look closely, therefore, at whether the buyout produces a reasonable level of estimated cost savings to ratepayers, subject to true-up, and taking into account the buyout payment terms and the expected reduction in energy payments.[3] We also look closely at whether the qualifying facility is likely to continue in operation, since it would make no sense to make buyout payments to an energy supplier that was not likely to stay in business under the existing contract.[4]

SCE has demonstrated to our satisfaction that the cogeneration facility meets the Commission's viability criteria and that the buyout will produce

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[3] D.99-02-085, mimeo., at p. 29.

[4] Also, see *In re Power Purchase Contracts Between Electric Utilities and Qualifying Facilities*, D.88-10-032, 29 CPUC2d 415 (1988).

significant and robust savings for its ratepayers under a range of economic and operational assumptions. Further, we find that the agreed-upon ratepayer benefit of $32.5 million NPV is reasonable.

As stated above, ORA and SCE resolved their disagreement regarding the projected ratepayer benefit resulting from the restructuring agreements. Although the stipulation reached between ORA and SCE was not a formal settlement, we will apply our criteria governing acceptance of settlements. The Commission will not approve a settlement unless it is "reasonable in light of the whole record, consistent with law, and in the public interest."[5] We described the applicable criteria in D.88-12-083; 30 CPUC2d 189, 222.

Regarding the restructuring agreements, we have reviewed SCE's discussion of the settlement process and terms, and find that the settlement embedded in the restructuring agreements fully satisfies these criteria. We will not reveal the details of the restructuring agreements, except to say that it resulted in SCE negotiating for the best available buyout price. We have evaluated SCE's calculations of the settlement value, and find that it falls well within the range of possible outcomes.

In sum, we find SCE's application to be reasonable and will approve it, subject to the modification in the calculation of ratepayer benefit, and associated shareholder incentive reward as agreed to by SCE and ORA.

Position of SoCalGas

SoCalGas does not oppose the application and describes the restructuring of the power purchase agreement (PPA) between SCE and AES as a "win-win" result for all affected parties. According to SoCalGas, the restructuring permits

[5] Rules of Practice and Procedure, Rule 51.1(e). (See D.93-03-058.)

SCE to obtain electric ratepayer benefits through termination of the PPA at the earliest possible date and permits SoCalGas to obtain gas ratepayer benefits through the execution of a new long-term gas transportation agreement with AES. Accordingly, SoCalGas requests that its Advice Letter 2806, which requests approval of a 10-year tariff agreement between AES and SoCalGas to replace the previous long-term gas transportation contract between them, be approved.

We will address Advice Letter 2806 separately under the Commission's advice letter procedure.

Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

Findings of Fact

1. SCE's internal evaluation and the reports of Energy Options and Duke Engineering confirm that the AES project is technically and economically viable for the remainder of the contract period.

2. Based on SCE's economic analysis, the restructuring agreement should result in estimated ratepayer savings from $33.6 million to $46.1 million NPV.

3. For purposes of calculating the shareholder incentive reward, ORA and SCE reached agreement that the estimated ratepayer savings should be $32.5 million, and the shareholder incentive reward should be $3.25 million.

4. The stipulation reached between ORA and SCE, although not a formal settlement, satisfies the criteria set forth by the Commission in Rules 51 et seq.

Conclusions of Law

1. The stipulation between SCE and ORA is reasonable in light of the whole record, consistent with the law, in the public interest, and should be approved.

2. SCE's application, as modified to reflect the agreement reached between ORA and SCE, setting the estimated ratepayer savings and shareholder incentive reward at $32.5 million and $3.25 million, respectively, should be approved.

3. SCE's request for recovery of expenses incurred under the termination agreement should be conditioned on SCE's reasonable performance of its obligations and exercise of its rights under the agreement. Rate recovery should also be subject to the rate freeze provisions of Pub. Util. Code § 330 et al.

4. Commissioner Neeper's ruling that a hearing is not required in this proceeding should be affirmed.

5. In all other respects, the rules and procedures in Article 2.5 of the Commission's Rules shall cease to apply to this proceeding. However, the proposed schedule and scope of issues contained in the scoping memo shall continue to apply.

ORDER

IT IS ORDERED that:

1. The application of Southern California Edison Company (SCE) seeking approval of a contract restructuring agreement, which will end SCE's obligation to pay above-market rates for 98.7 megawatts (MW) of base contract capacity and 11.3 MW of supplemental contract capacity and associated energy from AES Placerita, Inc. (AES), is approved.

2. The stipulation between the Office of Ratepayer Advocates and SCE, which fixes estimated ratepayer savings resulting from the restructuring agreement at $32.5 million and the shareholder incentive reward at $3.25 million, is adopted.

3. The restructuring agreement as set forth in Exhibit SCE 2 of the application is reasonable, and SCE's actions in entering into the agreement were prudent.

4. SCE is authorized to recover in rates all payments under the restructuring agreement, to the same extent as any other cost associated with a qualifying facility is recoverable, subject only to SCE's prudent administration of the restructuring agreement and the rate freeze provisions of Pub. Util. Code § 330 et al.

5. Under Rule 6.6, this order is a final determination that a hearing is not needed in this proceeding.

6. This proceeding is closed.

This order is effective today.

Dated August 5, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners