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Decision 99-10-016 October 7, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application For Expedited and *Ex Parte* Approval Of Termination Of Standard Offer No. 2 Power Purchase Agreement Between Pacific Gas And Electric Company (U 39 E) And San Joaquin Cogen Limited, L.P. (U 39 E)	Application 99-04-009 (Filed April 8, 1999)

INTERIM OPINION

Pursuant to §§ 701 and 2821 of the Pub. Util. Code and Rules 15 and 42 of this Commission's Rules of Practice and Procedure (Rules), Applicant Pacific Gas and Electric Company (PG&E) seeks the Commission's expedited and *ex parte* approval of a proposed Termination and Settlement Agreement (Termination Agreement) that would terminate the existing Standard Offer No. 2 Power Purchase Agreement (PPA) between PG&E and San Joaquin Cogen Limited (San Joaquin).

The application was filed on April 8, 1999 and was noticed on the Daily Calendar on April 13, 1999. The Office of Ratepayer Advocates (ORA) and Libby-Owens-Ford Co. (LOF) filed limited protests which resulted in the issue of Commission approval of the Termination Agreement being bifurcated and going forward as an uncontested matter pursuant to Assigned Commissioner's Ruling dated August 12, 1999.

I. Timing

The application states that the Termination Agreement will result in approximately $240 million ($100 million on a net present value (NPV) basis) in

ratepayer benefits and will resolve costly and complex litigation between the parties. Under the agreement, San Joaquin's 30-year PPA will terminate on December 31, 1999 and litigation between PG&E and San Joaquin will be dismissed with a full release of claims. The Termination Agreement is contingent on Commission approval. If termination is approved by the Commission, San Joaquin may shut down the facility or make other significant operational changes. San Joaquin needs sufficient lead time before PPA termination to effectuate those changes. Thus, it is essential the Commission act expediently on this Application as San Joaquin may cancel the Termination Agreement if Commission approval has not been obtained by October 15, 1999. PG&E seeks *ex parte* and expedited approval of the Termination Agreement to meet the October 15 deadline and preserve the $100 million in ratepayer benefits.

San Joaquin and PG&E executed the Termination Agreement on March 9, 1999. PG&E seeks, on an *ex parte* and expedited basis a Commission order finding the Termination Agreement reasonable, approving it, and finding PG&E's actions in entering the Termination Agreement to be prudent.

II. Background

A. The San Joaquin PPA and Natural Gas Transportation Service Agreements

The PPA between PG&E and American Cogen Technology (predecessor to San Joaquin) is a 30-year Standard Offer No. 2 with a contract capacity of 49,900 kW. The PPA was assigned to San Joaquin in 1986. San Joaquin started energy deliveries on January 9, 1990 and demonstrated 48.2 MW firm capacity on April 8, 1990. San Joaquin receives short run avoided costs (SRAC) prices for energy deliveries and $209/kW year for firm capacity. The PPA terminates on April 7, 2020.

Under Pub. Util. Code §§ 218.5 and 454.4, qualified cogenerators are entitled to discounted natural gas transportation service. San Joaquin received this discount between 1990 and 1997 based on its representations to PG&E that the San Joaquin Facility satisfied the § 218.5 requirements. A dispute arose and litigation was commenced. PG&E removed San Joaquin from the discounted rate in April, 1997, shortly after filing its lawsuit.

B. The San Joaquin Facility

San Joaquin and other affiliated entities own and operate a 49.9 MW gas-fired cogeneration facility in Lathrop, California which provides electricity and capacity to PG&E (San Joaquin Facility). The San Joaquin Facility generates electricity, which it sells to PG&E, and steam, which it sells to Libbey-Owens-Ford Company (LOF) for various processes at the adjacent LOF glass manufacturing facility. Destec (now known as Dynegy Power Corp.) built the facility between 1988-1989.

The San Joaquin Facility demonstrated firm capacity on April 8, 1990. Since then the facility has consistently performed well and has earned all annual performance bonuses.

C. PG&E's Compliance Monitoring Program

In 1989, PG&E implemented a monitoring program to verify that cogenerators receiving natural gas transportation discounts satisfied the Section 218.5 requirements. Two years later, PG&E instituted a program to monitor QFs' compliance with the Public Utility Regulatory Policies Act (PURPA) operating and efficiency standards pursuant to the Commission's order in Decision (D.) 91-05-007 and D.91-08-36.

Since 1991, San Joaquin has given operating data to PG&E to monitor § 218.5 and PURPA compliance. Based on this data, PG&E determined the

San Joaquin Facility complied with these requirements. In addition, San Joaquin also submitted cogeneration declarations with its natural gas transportation agreements. In these declarations, San Joaquin represented under penalty of perjury that the facility "meets and will continue to meet the efficiency standards. . . [in] Section 218.5" and San Joaquin "will notify PG&E within thirty (30) days in writing of any circumstances that render the facility incapable of meeting [these standards]." PG&E employees also conducted site inspections of the San Joaquin Facility to familiarize themselves with the facility and further substantiate compliance.

D. The Dispute Concerning § 218.5 and PURPA Compliance

PG&E received information in late Fall 1996 that San Joaquin and LOF may have been inappropriately reporting steam released to the atmosphere as part of the San Joaquin Facility's "useful thermal energy output" requirements under PURPA, 18 CFR § 292.205, *et. seq.* and § 218.5. PG&E investigated whether there was a substantial basis for these concerns over the next several months. In April 1997, PG&E filed a civil lawsuit against San Joaquin alleging fraud, breach of contract and unfair business practices related to San Joaquin's failure to comply with § 218.5. PG&E later added LOF as a defendant. In the almost two years since PG&E filed its case there has been intensive discovery, including extensive discovery motion practice. Trial is currently set for December 13, 1999. The parties have agreed to a discovery stay to permit the preparation of this Application and to allow for settlement talks between LOF and San Joaquin.

E. Settlement Talks Between the Parties

Settlement discussions began between PG&E and San Joaquin officers shortly after PG&E filed its Superior Court action in April, 1997. In Spring 1998, PG&E, San Joaquin and LOF agreed to participate in a settlement mediation

attended by senior officers. There was progress towards settlement during two days of discussions before a mediator in July 1998, but no agreement. There were many additional discussions in the months following the mediation. PG&E reached agreement in principle with San Joaquin on December 22, 1998, in a meeting attended by both sides' officers and counsel. PG&E and San Joaquin then worked on finalizing the Termination Agreement which was executed on March 9, 1999.

III. Termination Agreement Terms

The Termination Agreement's significant public terms are:

- The PPA terminates on December 31, 1999 (§ 2.1)
- Upon termination, PG&E has no obligation to purchase and San Joaquin has no obligation to provide electricity or capacity (§ 2.2)
- San Joaquin and PG&E release all claims against each other and PG&E dismisses with prejudice its complaint against San Joaquin (§§ 8-9)
- San Joaquin demonstrates PURPA compliance for 1999 (§ 11.4)

The Termination Agreement is conditioned on:

- Commission approval before October 15, 1999 (§§ 5.1-5.7)
- San Joaquin not filing bankruptcy within 90 days of execution (§§ 6.1-6.2)
- Approval by San Joaquin's lenders (§§ 10.1-10.3)

IV. The Termination Agreement Is Reasonable And Should Be Approved

A. Standards Governing This Application

This Application seeks Commission approval for the termination of San Joaquin's PPA. An applicant requesting such approval must make a persuasive showing the ratepayers will benefit from termination and a showing

the generating facility is viable and not likely to be shut down before the expiration of the contract. (*See Southern California Edison,* D.97-07-039 (1997); *Southern California Edison,* D.97-03-035 (1997).)[1] These criteria are fully satisfied by the Termination Agreement.

B. The Termination Agreement Satisfies The Commission's PPA Termination Standards

1. The Termination Agreement Will Yield Substantial Ratepayer Benefits.

The Termination Agreement will provide approximately $240 million ($100 million NPV) in ratepayer benefits. The PPA is a 30-year SO2 with more than 20 years remaining before it expires. Under the PPA, PG&E pays for energy at SRAC prices and must pay capacity prices ($209/KW year) which are entirely above-market. Pursuant to § 367, these costs are passed through to PG&E's ratepayers. By terminating the PPA on December 31, 1999, PG&E's ratepayers will save $240 million ($98.2 million NPV) in future costs.

The Termination Agreement also benefits PG&E's ratepayers by eliminating substantial future litigation costs. PG&E estimates that continuing the civil litigation through trial and a likely appeal would force PG&E to incur over $1 million in legal fees and costs. PG&E also estimates that it would incur approximately $1 million in litigation costs to pursue its PURPA claims at FERC. To recover damages for San Joaquin's failure to comply with PURPA, PG&E must petition the FERC. (*IEP,* 36 F.3d at 855.) Because QF decertification and

[1] The Commission's recent decision regarding QF contract modification issues did not change these standards. (*See Re Order Institution Rulemaking on the Commission's Proposed Policies Governing Restructuring California's Electric Services Industry,* D.99-02-085, mimeo., at 19 (1999).)

refund proceedings may take years, PG&E believes that it would incur significant transaction costs pursuing its PURPA claims. (*See e.g. New Charleston Power I, L.P.*, FERC ¶ 61,378 (1993) (FERC refund proceeding after determination of non-compliance pending for five years).)

Finally, the Termination Agreement benefits PG&E's ratepayers by eliminating litigation uncertainty.

2. The San Joaquin Facility Is Viable

a) Historic Performance

The San Joaquin Facility commenced operation in January 1990. Since then, the facility has never failed to achieve the minimum performance requirements for the peak months of June, July and August; it has earned all annual performance bonuses.

b) Future Operational Viability

The information provided by San Joaquin in this Application and PG&E's own evaluation of the San Joaquin Facility's technical viability establish the facility is fully capable of performing at high levels of efficiency and output until the PPA terminates in 2020. The facility was originally designed by an experienced power plant construction firm and has been operated by an experienced crew. The facility's General Electric LM-5000 CTG is an aero-derivative gas turbine and has had nine years of reliable performance. The San Joaquin Facility was designed and as a baseload cogeneration project with the capability of running 24 hours a day. Similarly designed plants have demonstrated the ability to perform for 30 years with no major difficulties. The facility uses proven technology and quality equipment and is well maintained.

c) Economic Viability

In connection with restructuring a QF's power purchase agreement PG&E must also satisfy itself of the project's economic viability for the remaining term of the PPA. The QF project is assumed to be viable if it is expected to have a positive "contribution to margin." Contribution to margin in this context is defined as the difference between the project's operating revenues and its operating costs. A power plant that is capable of generating power at a cost lower than the price it receives is unlikely to terminate operations. The business entity that owns the generating facility may or may not be profitable depending on a variety of factors. A QF operating at a loss will likely be reorganized under bankruptcy protection or sold. While the investors and creditors may lose money, the facility will continue to operate, deliver power and receive payments under the PPA.

There is good reason to believe San Joaquin will continue to operate for the remainder of the PPA as a result of the energy and capacity prices it is guaranteed to receive.

d) Environmental and Regulatory Compliance

The San Joaquin Facility is subject to various environmental permits and requirements with which the facility has complied in the past. San Joaquin expects it will continue to comply with these requirements. Under the PPA, San Joaquin would also be required to comply with PURPA until April 2020. San Joaquin provided 1998 operating data to PG&E during the negotiation of the Termination Agreement to verify the San Joaquin facility's compliance with PURPA and § 218.5 in 1998. This operating data included plant data, steam invoices, natural gas invoices and PG&E's power purchase statements. PG&E had its employees and an outside consultant independently review this information. PG&E's employees and its consultant concluded the

San Joaquin Facility complied with PURPA and Section 218.5 in 1998 based on this data.

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. PG&E requests Commission approval of a Termination Agreement that would terminate a Standard Officer No. 2 Power Purchase Agreement between PG&E and San Joaquin Cogen Limited (San Joaquin).

2. The application shows that PG&E ratepayers will benefit from approval of the Termination Agreement.

3. The application shows that the generating facility involved is viable and not likely to be shut down before the expiration of the contract.

4. Notice of the filing of the application regularly appeared on the Commission's Daily Calendar.

5. The application was bifurcated so that this decision concerns only Commission approval of the Termination Agreement.

6. ORA supports Commission approval of the Termination Agreement.

7. LOF does not protest Commission approval of the Termination Agreement, but requests certain limiting language in the Commission's Order to which PG&E agrees.

8. Because the public interest would best be served by having the Commission's approval of the Termination Agreement expeditiously, the ensuing Order should be made effective on the date of issuance.

Conclusions of Law

1. Applicant's actions in entering in the Termination and Settlement Agreement were prudent.

2. The Termination Agreement should be approved.

INTERIM ORDER

IT IS ORDERED that:

1. The Termination and Settlement Agreement attached to the application that would terminate the existing Standard Offer No. 2 Power Purchase Agreement between Pacific Gas and Electric Company (PG&E) and San Joaquin Cogen Limited (San Joaquin) is reasonable and approved.

2. This Order does not constitute a finding of fact or conclusion of law regarding the merits of PG&E's lawsuit against San Joaquin and Libbey-Owens-Ford Company.

3. This Order is not intended to constitute findings of fact or conclusions of law as to "reasonableness" of the settlement in the context of civil litigation as compared to a Commission proceeding.

This order is effective today.

Dated October 7, 1999, at Los Angeles, California.

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