

Decision 99-10-023 October 7, 1999

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of Southern California Edison  
Company for order approving Amendment No. 2  
to power purchase agreement between Edison  
and Colmac Energy, Inc.

Application 98-12-038  
(Filed December 23, 1998)

**O P I N I O N**

**Summary**

By this decision, we approve Southern California Edison Company's (SCE) proposed buyout and termination of a 1985 power purchase agreement with Colmac Energy, Inc. (Colmac). Expected customer benefits from the buyout are \$56 million in net present value (NPV).

**Background**

Colmac is a qualifying facility (QF).<sup>1</sup> It operates a 45 megawatt biomass facility near Mecca, California, which is located in the Imperial Irrigation District's (IID) service territory. Energy and capacity generated by the project is delivered to SCE's transmission system through IID's transmission lines. The facility is designed to both generate electricity and be a waste resource recovery facility that burns a combination of wood and agricultural waste. Wood waste

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<sup>1</sup> 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.

from local landfills and local agricultural waste are major sources of the project's fuel.

On April 17, 1985, SCE and Colmac executed the 30-year Interim Standard Offer 4 (ISO4) contract, the standard at that time for long-term contracts between utilities and QFs. On January 6, 1986, Colmac requested that SCE consent to a change in the project's location about six miles from the original site. This request resulted in a subsequent complaint, hearings and briefings. By D.89-04-081, SCE was directed to execute an amendment incorporating Colmac's new project site and granted the extensions sought by Colmac.

Colmac achieved firm operation on February 4, 1992. Accordingly, the ISO4 contract term ends on February 3, 2022. The contract provides for a capacity price of \$198/kW-yr for 45,000 kilowatts (kW) of dedicated firm capacity for the entire contract term. Under the contract, Colmac is also entitled to receive a capacity bonus for performance above the 85% capacity factor during the summer on-peak hours and the winter mid-peak hours.

Energy payments during the first ten years of the contract term are based on the annual marginal cost forecast of energy prices in the contract. For 1998, the forecasted energy price is \$0.146/kWh. For the remainder of the ten-year fixed price period (i.e., until February 3, 2002), the contract price for energy is \$0.156/kWh. From February 4, 2002 until the end of the contract term, Colmac will be paid SCE's avoided energy price.

On December 23, 1998, SCE filed an application for approval of the buyout and termination agreement. SCE also proposes to retain 10% of the ratepayer benefits resulting from the buyout, pursuant to the Commission's authorization in Decision (D.) 95-12-063, as modified by D.96-01-009.

The Office of Ratepayer Advocates (ORA) filed comments in support of the application. Riverside County (Riverside) opposed the application on the

grounds that the contract termination agreement would lead to plant closure which, in turn, would pose a serious risk to achieving waste diversion goals in the majority of Riverside's 24 cities and the County itself. According to Riverside, this would result in fines to the residents of Riverside County and its cities. Riverside requested that SCE be directed to prepare an independent study of those costs prior to evidentiary hearings on the issue. SCE argued that this issue was beyond the scope of this proceeding. ORA objected to Riverside's request for ratepayer funding of such a cost study.

The Assigned Commissioner and Administrative Law Judge (ALJ) conducted prehearing conferences on March 16, 1999 and April 28, 1999. At the request of the Assigned Commissioner and ALJ, Riverside and SCE submitted briefs on the issue of whether the California Environmental Quality Act (CEQA) is applicable to this proceeding. Riverside contended that it was applicable; SCE argued that it was not.

SCE, Colmac and Riverside agreed to attempt to reconcile their differences via mediation, and met with a mediator from the ALJ Division during May and June, 1999. However, the parties could not reach agreement.

Pursuant to Rule 6.1, the Commission preliminarily determined in Resolution ALJ 176-3008 that this is a ratesetting proceeding that was expected to go to hearing. On July 12, 1999, the Assigned Commissioner issued a scoping memo and ruling determining that evidentiary hearings would not be needed in this matter. In making that determination, the Assigned Commissioner ruled that CEQA is not applicable to this proceeding:

"...[A]pproval of SCE's application may affect the timing of changes in the economics of wood waste disposal in Riverside—by a couple of years. However, the inevitability of those changes, given the end of fixed energy prices under Colmac's current contract, has been known to market participants for several years. Whether that

change happens now, or two years from now, Colmac will presumably become less willing to pay the prices it has been paying for wood waste. Should Riverside believe, as it apparently does, that the changed economics of the Colmac plant will result in its closing, it is within the ability of Riverside to either prevent the plant's closing by negotiating alternative financial arrangements, or to eliminate the environmental consequences of such a closing by pursuing waste diversion options.

"Therefore, I conclude that the real consequences of SCE's application are economic ones specific to the existing financial arrangement between Riverside, Colmac and certain private entities involved in waste diversion in Riverside County. This is a very different case from a request for a permit to construct. As SCE points out, CEQA is clear that economic considerations are not environmental impacts that fall within CEQA's purview. (SCE Brief, p. 8.) Moreover, as discussed above, there is no evidence to support a finding that Commission approval of the buyout will result in the shutdown of the Colmac facility, as Riverside presumes in its pleadings.

"[SCE] and Riverside both acknowledge that the Commission has previously found that ratemaking proceedings, such as the present case, are not subject to CEQA. (See SCE's Brief, pp. 5-7.) The Commission always has the authority to find that a particular ratemaking proceeding could in fact be subject to CEQA. However, based on the record before me, I do not recommend a deviation from the Commission's general precedent in this case." (Scoping Memo and Ruling Of Assigned Commissioner, July 12, 1999, pp. 6-7.)

The Assigned Commissioner also denied Riverside's request to address the potential cost impacts to Riverside in this proceeding:

"We agree with SCE that Riverside has no basis to expect, or demand, that SCE demonstrate lack of economic harm to Riverside in this proceeding. Riverside is not a party to the power purchase contract that is being amended and, furthermore, by Commission decision, there are no third-party beneficiaries under a standard offer contract. (See Decision (D.) 83-10-093 and D.98-09-073.)

"Therefore, we will not address potential cost impacts to Riverside in this proceeding." (*Id.*, p. 8.)

We have considered our preliminary determination regarding the need for hearings in this matter and the Assigned Commissioner's ruling. By this order, we affirm the Assigned Commissioner's July 12, 1999 determinations that no evidentiary hearings are required in this proceeding.

### **Project Viability and Ratepayer Benefits**

There is no contention over the facts presented in this case on the viability issue. SCE internally evaluated the project's economic and technical viability and retained Rigo & Rigo Associates, Inc. (Rigo & Rigo), a third-party consultant with expertise in energy plants, to verify Colmac's viability. Rigo & Rigo inspected Colmac's generating facility on three separate occasions in three different years, reviewed relevant financial and technical information, and performed an independent evaluation of the information that Colmac provided. In particular, Rigo & Rigo carefully evaluated the reliability of the plant, in light of its erratic output and capacity factor for the first two years of operation (1992 and 1993).

As Rigo & Rigo explain in their report, the facility was not operated at that time by Colmac's principals. In 1994, Colmac's principals took over the project's day-to-day operations. Since that time, the project's work force stabilized and the principals undertook major facility upgrades in 1995. Thereafter, the project's reliability steadily improved. For the last three years, the project has had an average capacity factor of 89.5%, and exceeds typical industrial power standards. This level of performance is expected to continue.

Rigo & Rigo reports that the project's computerized tracking and scheduling will ensure the performance of preventative maintenance. In addition, the project has an extensive spare parts inventory and skilled machine

shop and millwright capabilities. These capabilities, together with the inventory and tracking program will allow the project to promptly respond to most failures and minimize the cost of maintaining high reliability. Rigo & Rigo's site visits also confirm that the facility is a well-designed, built, operated and maintained plant. The assessment of regional wood waste supply indicates that there is more than enough agricultural waste and waste wood to continue to meet Colmac's fuel requirements throughout the contract term, and that the wood waste can also be expected to remain economic.

Rigo & Rigo used an integrated technical and economic assessment model to evaluate whether the facility would continue to earn profits during the remainder of the contract term. This model simulates what happens over a range of assumptions concerning expected plant performance, operation and maintenance and fuel costs. The results of the model establish that Colmac is expected to enjoy strong net revenue and profit streams for the remainder of the contract term, even under the lowest (5%) probability case.

ORA agrees with SCE's conclusion that there is no foreseeable impediment to the successful operation of the facility throughout the remainder of the ISO4 agreement's term.

ORA and SCE also agree that a reasonable estimate of the benefits of the buyout from the perspective of cost savings is \$56 million in NPV.<sup>2</sup> These cost savings result from the replacement of Colmac's high energy and capacity prices under the existing contract with lower-priced energy and capacity based on SCE's projected replacement costs, net of termination payments. SCE performed sensitivity analyses that examined how the forecast market prices during the

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<sup>2</sup> January 1, 1999 NPV @ 10 percent discount rate.

remaining years of the contract would affect these cost savings. SCE's analyses produce savings that range from \$30.9 million to \$67.7 million in NPV, taking into account varying assumptions concerning energy price and plant performance.

ORA also conducted a further ratepayer benefit analysis to assess the headroom impact of savings. By "headroom impact," ORA refers to cost-savings from the buyout that occur during the rate freeze period. ORA examines this impact to evaluate whether the benefits to ratepayers are robust and reasonable after the rate freeze period relative to the projected benefits to SCE's shareholders during the rate freeze period. ORA concludes that the headroom impact of savings associated with this particular buyout arrangement is not unreasonable, and supports both the terms of the buyout agreement and the 10% shareholder incentive that SCE requests.

### **Discussion**

The Commission scrutinizes the reasonableness of buyouts on a case-by-case basis. We look closely at whether the buyout produces a reasonable level of cost savings to ratepayers, taking into account the buyout payment terms and the expected reduction in energy payments. We also look closely at whether the QF project 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.

SCE has demonstrated to our satisfaction that Colmac meets the Commission's viability criteria and that the buyout will produce significant and robust savings for its ratepayers under a range of economic and operational assumptions. Further, we find that the projected ratepayer benefits of \$56 million in NPV are reasonably commensurate to with the level of net benefits accruing to Colmac from the buyout, i.e., the difference between the buyout

amount and the projected net income to Colmac from continuing to operate the facility. We also agree with ORA's assessment that terms of this agreement do not create an unreasonable allocation of benefits to reducing non-QF headroom during the rate freeze period.

In sum, we find SCE's application to be reasonable and will approve it, along with SCE's request to retain 10% of the ratepayer benefits pursuant to D.95-12-063, as modified by D.96-01-009.

### **Comments on Draft Decision**

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were filed on September 1, 1999 by Riverside, and (jointly) by ORA and SCE. SCE filed reply comments on September 8, 1999. We note that Riverside alleges that Colmac will stop operating and, therefore, that CEQA applies to this application. We disagree. As indicated above, the Assigned Commissioner presented several bases for the conclusion that CEQA does not apply to this application. His conclusions, and ours, do not depend on the extent to which it is likely that Colmac will cease operating following the restructuring of its contract.

In response to the joint comments of ORA and SCE, we made minor modifications to the calculation of ratepayer benefits to reflect the actual timing of this decision relative to the date anticipated in the application. We make no other substantive changes to the draft decision.

### **Findings of Fact**

1. By ruling dated July 12, 1999, the Assigned Commissioner determined that the scope of issues in this proceeding should not include CEQA review or the



potential cost impacts to Riverside of the proposed contract termination. No other issues were contested.

2. Frequent site visits have confirmed that the Colmac generating facility is a well-designed, built, operated and maintained plant. For the last three years, the project has had an average capacity factor of 89.5%, and this level of performance is expected to continue. The project's computerized tracking and scheduling capability, extensive spare parts inventory, skilled machine shop and millwright capabilities will allow the project to promptly respond to most failures and minimize the cost of maintaining high reliability. In addition, the supply of agricultural waste and waste wood in the region is expected to continue to meet Colmac's fuel requirements at economic prices.

3. All parties agree that Colmac will continue to earn reasonable profits under the existing contract.

4. The benefits of the buyout from the perspective of cost savings is expected to be \$56 million in NPV. These estimates are reasonably commensurate with the level of net benefits accruing to Colmac from the buyout, i.e., the difference between the buyout amount and the projected net income to Colmac from continuing to operate the facility.

5. The terms of this agreement do not create an unreasonable allocation of benefits to reducing non-QF headroom during the rate freeze period.

### **Conclusions of Law**

1. The Assigned Commissioner's ruling dated July 12, 1999 regarding the scope of issue in this proceeding, the applicability of CEQA, and the need for hearings is reasonable.

2. SCE's December 23, 1998 application is reasonable and 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. Because all issues have been addressed by this decision, this proceeding should be closed.

5. In order to proceed expeditiously with the proposed buyout, this decision should be effective today.

## **O R D E R**

### **IT IS ORDERED that:**

1. This order is a final determination that a hearing is not needed in this proceeding.

2. The December 23, 1998 application of Southern California Edison Company (SCE) for approval of the contract termination between SCE and Colmac Energy Inc. is approved.

3. The termination agreement as set forth in Exhibit SCE-2 of the application is reasonable, and SCE's actions in entering into the agreement were prudent. The termination agreement achieves an estimated savings of \$56 million, 10% of which (\$5.6 million) shall be used for purposes of calculating the shareholder incentive payment authorized in Decision (D.) 95-12-063, as modified by D.96-01-009.

4. SCE is authorized to recover in rates all payments under the termination 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

termination agreement and the rate freeze provisions of Pub. Util. Code § 330 et al.

5. This proceeding is closed.

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