Decision ______________

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 Sunnyside Cogeneration Partners, L.P.	Application 08-07-028 (Filed July 17, 2008)

DECISION APPROVING SETTLEMENT REGARDING STANDARD OFFER NO. 2 POWER PURCHASE AGREEMENT

This decision approves a settlement between Pacific Gas and Electric Company (PG&E) and Sunnyside Cogeneration Partners, L.P. (Sunnyside) concerning a Standard Offer No. 2 power purchase agreement (PPA) that PG&E and Sunnyside's predecessor signed in 1985. Under the PPA, PG&E purchased firm capacity and energy from the qualifying facility owned by Sunnyside until differences arose between the parties as to whether PG&E could change the terms of dispatch applicable to Sunnyside.

The settlement we approve today will result in cancellation of the PPA, as well as the dismissal of lawsuits that PG&E and Sunnyside have brought against each other. The decision also authorizes PG&E to recover in rates the payment to be made to Sunnyside pursuant to the settlement agreement.

1. Background

On August 8, 1985, Pacific Gas and Electric Company (PG&E) and the predecessor of Sunnyside Cogeneration Partners, L.P. (Sunnyside), Grenco Associates, Inc. d/b/a Sunnyside Cogen (Grenco), entered into a power purchase agreement (PPA) for firm capacity and energy to be generated from Grenco's natural gas-fired facility (Facility) in Salinas, California. The agreement the parties used was a Commission-approved standard form qualifying facility (QF) contract that is commonly referred to as a Standard Offer No. 2 (SO2) contract. Under this PPA, Grenco committed to make available and deliver to PG&E a contract capacity of 5,500 kilowatts (kW) for a period of 30 years. In addition, Grenco elected the firm capacity payment option in SO2, which required the project to be dispatchable.[1] In 1990, Sunnyside purchased the operational project from Grenco, and Grenco assigned its PPA to Sunnyside.[2]

According to the application, from 1991 (when the Facility began delivering firm capacity) until 2005, PG&E usually requested that Sunnyside deliver its full contract capacity 5 days per week, 13 hours per day (5x13). However, in late 2005, based on the high cost of gas and the low fixed energy price then applicable to Sunnyside's deliveries, PG&E notified Sunnyside that as of January 1, 2006, it would be dispatching the Facility to operate on a schedule of 7 days per week , 24 hours per day (7x24). (Application, p. 3.)

Sunnyside refused to comply with this new dispatch requirement, claiming that PG&E's previous course of performance (*i.e.,* 5x13 dispatches) and

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[1] The SO2 agreement between PG&E and Sunnyside defines "dispatchable" as follows:

> "The <u>Facility</u> is operable and can be called upon at any time to increase its deliveries of capacity to any level up to the <u>contract capacity</u>." (Emphasis in original.)

[2] The PPA is attached as Exhibit 2 to both the public and the confidential, non-public versions of the declaration of PG&E's counsel, Shari Hollis-Ross, in support of the application.

the fixed energy price amendment[3] limited PG&E's ability to dispatch the Facility, and that PG&E had waived the right to dispatch the Facility on other than a 5x13 basis. In addition, Sunnyside claimed that complying with the 7x24 dispatch requirement would cause it to violate operating and efficiency standards that would jeopardize its QF status under regulations promulgated by the Federal Energy Regulatory Commission (FERC). PG&E refused to modify its 7x24 dispatch demand, and Sunnyside thereupon ceased operations. PG&E then placed Sunnyside on a 15-month probationary period pursuant to the PPA for failing to meet its firm capacity performance obligations under the agreement. (*Id.*)

In May 2006, Sunnyside filed a breach-of-contract action against PG&E in the Superior Court in and for the City and County of San Francisco, which included allegations of waiver and bad-faith dealing. On March 31, 2007, the 15-month probationary period provided for in the PPA expired, with Sunnyside failing to cure the performance deficiencies described by PG&E. PG&E then derated Sunnyside's firm capacity amount to zero and sent a demand to Sunnyside seeking repayment of approximately $4.5 million in capacity overpayments, based on Sunnyside's failure to meet its 30-year commitment to deliver firm capacity. Sunnyside did not respond to PG&E's demand for repayment.

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[3] After PG&E filed for protection under Chapter 11 of the Bankruptcy Act in April 2001, the Commission approved a 5-year fixed energy price of 5.37 cents/kWh to replace the energy price terms based on short-run avoided cost that appeared in many standard QF contracts. (Decision (D.) 01-06-015, p. 4.) PG&E and Sunnyside entered into an amendment to their PPA providing for this fixed energy price in July 2001. (Application, p. 4.)

The application continues that on May 14, 2007, PG&E filed its own action in the Superior Court in and for the City and County of San Francisco; this action sought repayment of the capacity overpayments to Sunnyside. In February 2008, at PG&E's request, the Court consolidated both cases for all purposes, and in March 2008 set the consolidated matters for trial in September 2008. (*Id.*)

Settlement discussions between representatives of PG&E and Sunnyside had begun in April 2007, and these discussions continued during July and August of that year. Ultimately, on April 2, 2008, the parties reached a tentative settlement agreement with the assistance of Superior Court Judge Tomar Mason. The agreement was then finalized and ultimately executed on May 28, 2008. The settlement agreement provides that its effectiveness is contingent upon approval by the Commission. (*Id.* at 3-4.)

The basic terms of the Settlement Agreement are simple. PG&E will make a payment to Sunnyside, whereupon the 30-year PPA between PG&E and Sunnyside will terminate, Sunnyside's and PG&E's respective actions in the Superior Court will be dismissed, and the parties will grant each other a full mutual release of both known and unknown claims. (*Id.* at 4.) As explained in further detail below, PG&E has requested that the amount of its payment to Sunnyside be kept confidential, and we agree that such confidential treatment is appropriate.

2. Standards for Reviewing QF Contract Settlements

The Commission has traditionally evaluated proposed QF settlements under the same standards that it uses for other settlements. Those standards are set forth in Rule 12.1(d) of our Rules of Practice and Procedure (Rules), which provides in full:

> "The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest."[4]

In determining whether a QF settlement satisfies the three standards in Rule 12.1(d), PG&E notes that Commission decisions have considered a number of factors, including:

- Whether the settlement reflects the relative risks and costs of continued litigation;
- Whether the settlement fairly and reasonably resolves the disputed issues and conserves public and private resources;
- Whether the agreed-upon settlement terms fall within the range of possible outcomes if the parties had continued to litigate their dispute;
- Whether the settlement negotiations were at arm's length and without collusion, whether parties were adequately represented, and how far the proceedings had progressed when the parties settled, and
- Whether the dispute between the QF and the utility presents a colorable claim that raises substantive issues of law or fact.

(*See* D.00-11-041 at 6-7 (citing cases); D.00-05-046, 6 CPCU3d 201, 202-03.) In the discussion below, we consider each of these five factors in the context of this case.

3. Discussion

As noted above, recent Commission decisions have identified five factors that are relevant in determining whether a proposed QF settlement meets the standards set forth in Rule 12.1(d).

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[4] Recent decisions in which QF settlements have been approved using these factors include D.06-05-034 and D.06-07-032.

With respect to the first of these factors—whether the settlement reflects the relative risks and costs of continued litigation—PG&E points out that the costs of trying the cases that it and Sunnyside have filed against each other (and then handling the almost-certain appeals) are likely to be in the range of $450,000 to $500,000. These costs are in addition to PG&E's exposure in the lawsuit brought by Sunnyside, which the application describes as follows:

> "Sunnyside's lawsuit is based on PG&E's alleged breach of the PPA by requiring Sunnyside to provide energy on a 7x24 basis. Although PG&E believes it had the right to so dispatch Sunnyside under the PPA and has developed substantial evidence in support of its position, PG&E's dispatch instructions for January 2006 departed from almost 15 years of consistent 5x13 dispatches. Under such circumstances, even with language in the PPA that PG&E believes allows it to modify the dispatch, Sunnyside may have colorable claims of waiver or modification of the contract by performance, which could entitle it to recover lost profits for the remainder of the life of the PPA. Sunnyside's expert's primary lost profit models estimate those lost profits to be in the $4 million to $4.5 million range. As such, it is unclear what the outcome of a trial before a jury would be." (Application, pp. 8-9.)

In view of this possible exposure, we believe that the settlement terms the parties have agreed to—which include a payment from PG&E to Sunnyside—are reasonable.

We think the foregoing analysis of litigation risk also addresses the second factor mentioned in some of our QF settlement decisions; *viz.*, whether "the settlement fairly and reasonably resolves the disputed issues and conserves public and private resources." (D.00-11-041 at 6.) The likely costs of trial and appeal, added to the risk that a jury might hold PG&E liable for Sunnyside's lost profits, make the amount PG&E has agreed to pay Sunnyside—an amount that we agree should be kept confidential—quite reasonable. Moreover, since the settlement agreement calls for dismissal of both lawsuits, plus mutual releases by both parties of all claims they may have against each other (whether known or unknown), the terms of the settlement will end the litigation between the parties and so help to conserve both public and private resources.

The analysis of litigation risk quoted above also addresses the third factor mentioned in the QF settlement decisions; *viz.*, whether the settlement terms "fall clearly within the range of possible outcomes had the parties fully litigated the dispute." (*Id.*) The amount PG&E has agreed to pay Sunnyside is significantly less than the sum of (a) the costs of trial and appeal, plus (b) the lost profits of Sunnyside for which PG&E might be held liable. Moreover, although PG&E has filed an action against Sunnyside seeking the return of approximately $4.5 million in excess capacity payments, there is real doubt whether PG&E would be able to collect on any judgment in its favor. On this issue, the application states:

> "Although PG&E believes that it would prevail with respect to its ability to pursue its affirmative claims and ultimately be awarded a judgment against Sunnyside, PG&E believes that ownership of the Sunnyside project is structured in such a way as to make recovery of any judgment against Sunnyside very difficult. Sunnyside is a limited partnership and the limited partner is owned by a trust that has, over time, distributed Sunnyside's profits to the trust's investors. Even were PG&E to obtain a significant judgment against Sunnyside, it could be faced with either a judgment-proof defendant or costly and challenging litigation against Sunnyside's limited partners and its parent on an alter ego or piercing the corporate veil liability theory. In addition, any recovery would be offset by the litigation costs incurred in defending against Sunnyside's claims." (Application, p. 9.)

In view of the possibility that PG&E might not be able to collect on any judgment it obtained that could offset its potential liability to Sunnyside, we believe the proposed settlement falls clearly within the range of outcomes that would be possible if the parties had continued to litigate their dispute.

The fourth set of factors mentioned above—whether the settlement negotiations were at arm's length and without collusion, whether parties were adequately represented, and how far the proceedings had progressed when the settlement was reached—is also satisfied here. The facts that (1) the first of the two lawsuits was filed in 2006, (2) the parties began settlement discussions in April 2007, (3) they did not reach a settlement until a year later, and (4) they needed the assistance of a Superior Court Judge to do so, are all strong evidence that this was a hotly-contested dispute and that the settlement involves no collusion. Similarly, it is evident that both sides were adequately represented, since, in addition to in-house counsel, PG&E and Sunnyside both retained experienced outside counsel to assist them in the discovery, motion practice and settlement negotiations that took place in the Superior Court actions.

There can also be little doubt that the dispute between the parties over what dispatch terms PG&E could impose on Sunnyside satisfies the fifth standard mentioned above for evaluating QF settlements; *viz.*, whether the dispute between the parties involves a significant claim raising substantive issues of law and fact. As the application states:

> "Sunnyside asserted claims for breach of contract, breach of the implied covenant of good faith and fair dealing and for declaratory relief. As discussed earlier, while PG&E believes it is in a position to mount a substantial defense to Sunnyside's claims, Sunnyside's lawsuit certainly raises substantial factual and legal issues to be decided independent of prior Commission decisions . . . [A]lthough the Commission has on occasion explained its policies concerning the standard offer PPAs, it has refrained from interpreting those contracts, instead leaving the issue of contract interpretation to the courts. *See* . . . D.93-11-019, 52 CPUC2d 87 (1993). Sunnyside's suit,

> therefore, raises substantive factual and legal questions for the court and a jury to decide, including whether PG&E had the right to dispatch the Sunnyside Facility on a 7x24 basis." (Application, p. 11.)

In view of all these factors favoring the instant settlement, it is also clear that the three tests set forth in Rule 12.1(d) for approval of a settlement have been met. First, the settlement "is reasonable in light of the whole record" because it will terminate the disputed PPA and dispose of two lawsuits, in one of which PG&E faces not-insignificant exposure. All of these actions will take place in exchange for a reasonable payment by PG&E to Sunnyside. Second, the parties have not identified any laws or prior Commission decisions with which the proposed settlement would be inconsistent. Third, the proposed settlement is in the public interest because it will dispose of costly litigation that has already lasted two years, thus freeing up the time of the courts, the Commission and the parties to pursue more worthwhile matters. Accordingly, we will grant PG&E's application and approve the settlement.

PG&E has requested that in addition to approving the settlement, we also authorize the company to recover the payment it will be making to Sunnyside "through the Energy Resource Recovery Account ('ERRA') or the Modified Transition Cost Balancing Account ('MTCBA'), as appropriate, as a cost of PG&E's energy procurement activities." (Application, p. 4.) We will grant this request, but point out that since the settlement here relates to an SO2 contract that was signed and went into effect before the electric restructuring process began in 1995 and 1996, recovery under the Modified Transition Cost Balancing Account (MTCBA) seems more appropriate, since a settlement relating to an early SO2 contract seems most reasonably characterized as a stranded cost or a transition cost.

4. PG&E's Request for Confidential Treatment of the Settlement Payment

In a motion filed contemporaneously with the application, PG&E requests that the amount of the settlement payment it proposes to make to Sunnyside be kept confidential, since "making this information public will give other QF entities engaged in Standard Offer contracts with PG&E information regarding PG&E's current strategic approach to resolving similarly situated contested Standard Offer contracts." PG&E also notes that it is required under the terms of its settlement agreement to keep the amount of the payment confidential.

Pursuant to Pub. Util. Code § 583, PG&E has filed under seal a full, non-public set of papers that includes the amount of the settlement payment to Sunnyside, as well as a redacted, public version of the papers that omits only the settlement amount.

We have granted similar requests for confidential treatment of QF settlements in many other decisions, some of which involved keeping the entire settlement agreement confidential. See, e.g., D.00-05-046, 6 CPUC3d at 203-04; D.00-11-041 at 9-10 (citing cases and granting confidential treatment for entire settlement agreement); D.02-06-074 at 6-7. We see no reason to depart from that approach here, especially since PG&E is seeking to keep confidential only the amount of its settlement payment to Sunnyside.

5. Category and Need for Hearing

In Resolution ALJ 176-3218, dated July 31, 2008, the Commission preliminarily categorized this proceeding as ratesetting and preliminarily determined that no hearing would be necessary. Based on the record in this uncontested proceeding, we conclude that a public hearing is not necessary, nor is it necessary to alter the preliminary determinations made in Resolution ALJ 176-3218.

6. Waiver of Comments

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2) and Rule 14.6(c)(2), the otherwise applicable 30-day period for public review and comment is waived.

7. Assignment of Proceeding

Michael R. Peevey is the assigned Commissioner, and A. Kirk McKenzie is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. On August 8, 1985, PG&E and Sunnyside's predecessor, Grenco, entered into an SO2 PPA.

2. Under the terms of the PPA, Grenco was to provide PG&E with 5,500 kW of firm capacity and energy from its Facility in Salinas, California for a period of 30 years.

3. Under the SO2 firm capacity payment option that Grenco selected, its Facility was required to be "dispatchable," a defined term in the PPA.

4. In 1990, Grenco assigned the PPA to Sunnyside, and PG&E gave its consent to the assignment.

5. From 1991 until 2005, PG&E generally requested that Sunnyside deliver its full contract capacity on a 5x13 basis.

6. In late 2005, PG&E notified Sunnyside that it was changing the dispatch terms, and that Sunnyside would be required to deliver its full contract capacity on a 7x24 basis beginning on January 1, 2006.

7. Sunnyside refused to comply with PG&E's new dispatch requirement, arguing that based on PG&E's dispatch requests from 1991-2005 and the fixed energy price amendment the parties had executed in 2001, PG&E had waived the right to demand dispatch from Sunnyside's Facility on other than a 5x13 basis.

8. Sunnyside also argued that complying with PG&E's new 7x24 dispatch requirement would cause Sunnyside to violate operating and efficiency standards that would jeopardize its status as a QF under the applicable FERC regulations.

9. Rather than comply with PG&E's demand for 7x24 dispatch, Sunnyside ceased operations in January 2006.

10. After Sunnyside refused to comply with its new dispatch demands, PG&E placed Sunnyside on a 15-month probationary period pursuant to the terms of the PPA for failure to meet its firm capacity performance obligations.

11. In May 2006, Sunnyside filed an action against PG&E in the Superior Court in and for the City and County of San Francisco. The action alleged that for the reasons set forth in Findings of Fact 7 and 8, PG&E's demand that Sunnyside change the dispatch of its Facility from 5x13 to 7x24 constituted a breach of contract under the PPA, as well as a breach of the implied covenant of good faith and fair dealing.

12. On March 31, 2007, the 15-month probationary period ended without Sunnyside having cured its performance deficiencies. Shortly thereafter, PG&E sent Sunnyside a demand for repayment of approximately $4.5 million in firm capacity overpayments, based on Sunnyside's failure to complete its 30-year firm capacity commitment under the PPA.

13. After Sunnyside did not respond to PG&E's demand for repayment, PG&E filed an action on May 14, 2007 against Sunnyside in the Superior Court in and

for the City and County of San Francisco seeking repayment of the capacity overpayments.

14. The parties commenced settlement discussions in April 2007, which continued into August 2007.

15. In February 2008, at PG&E's request, Sunnyside's action against PG&E and PG&E's action against Sunnyside were consolidated for all purposes including trial, and in March 2008 the Superior Court set the two matters for trial in September 2008.

16. In April 2008 the parties reached a tentative settlement of their dispute with the assistance of a Superior Court Judge. The parties signed the settlement agreement that is the subject of this application on May 28, 2008.

17. The settlement agreement between the parties calls for (a) PG&E to make a payment to Sunnyside, (b) Sunnyside and PG&E to dismiss their respective Superior Court actions against each other with prejudice, (c) Sunnyside and PG&E to give each other general releases of all claims they have or may have against each other, whether known or unknown, and (d) cancellation of the PPA between PG&E and Sunnyside.

18. Implementation of the above-described settlement agreement is contingent upon approval by the Commission.

19. PG&E has filed under seal a full copy of its application and the Settlement Agreement pursuant to Pub. Util. Code § 583. PG&E has also filed public, redacted versions of the settlement agreement and its application, both of which omit only the amount of the payment PG&E proposes to make to Sunnyside.

20. Notice of the filing of PG&E's application appeared in the Commission's Daily Calendar on July 25, 2008.

21. No protest to the application has been filed.

22. A hearing is not necessary.

23. PG&E has requested that it be allowed to recover the amount of its payment to Sunnyside in rates as a cost of its energy procurement activities, through either the Energy Resource Recovery Account (ERRA) or the MTCBA, as appropriate.

Conclusions of Law

1. In view of the costs of trying and handling appeals in Sunnyside's action against PG&E and PG&E's action against Sunnyside, plus PG&E's exposure in the event Sunnyside prevails in its breach of contract action against PG&E, the proposed settlement reasonably reflects the risks and costs of continued litigation.

2. In view of the risks summarized in Conclusion of Law (COL) 1, the proposed settlement fairly resolves the issues disputed between the parties, and will help to conserve public and private resources.

3. In view of the risks summarized in COL 1, plus the likelihood that PG&E would have great difficulty in collecting any judgment in its favor in the action it has brought against Sunnyside, the proposed settlement falls within the range of possible outcomes that would have resulted if PG&E and Sunnyside had continued to litigate their dispute.

4. In view of the fact that PG&E's and Sunnyside's respective actions against each other have each been pending for over 18 months, and have entailed extensive discovery and motion practice as well as the involvement of outside counsel on both sides, it is clear that the parties' settlement negotiations have been at arm's length and without collusion, have involved effective representation on both sides, and have occurred after enough time has elapsed so

that each party could make a realistic assessment of its odds of prevailing in the litigation.

5. The dispute between PG&E and Sunnyside presents a colorable claim that raises substantive issues of both law and fact.

6. In view of COLs 1-5, the proposed settlement between PG&E and Sunnyside is reasonable in light of the whole record, consistent with law, and in the public interest.

7. PG&E's application for an order approving the proposed settlement should be granted, subject to the conditions set forth in the following order.

8. PG&E should be allowed to recover the amount of its payment to Sunnyside in rates, either through the MTCBA or, if appropriate, the ERRA.

9. PG&E's motion to file under seal, pursuant to Pub. Util. Code § 583, (a) the full, unredacted version of its application, and (b) the full, unredacted version of the July 17, 2008 declaration of Shari Hollis-Ross in support of the application, to which the full, unredacted version of the Settlement Agreement is attached as Exhibit 1, should be granted.

O R D E R

IT IS ORDERED that:

1. The application of Pacific Gas and Electric Company (PG&E) for an order approving the Settlement Agreement between PG&E and Sunnyside Cogeneration Partners, L.P. (Sunnyside), which Settlement Agreement is attached as Exhibit 1 to the July 17, 2008 Declaration of Shari Hollis-Ross in support of the application, is granted.

2. The payment to be made by PG&E to Sunnyside pursuant to the Settlement Agreement approved herein may be recovered by PG&E in rates,

either through the Modified Transition Cost Balancing Account or, if appropriate, the Energy Resource Recovery Account, subject only to PG&E's prudent administration of the Settlement Agreement.

3. The July 17, 2008 motion of PG&E for leave to file confidential materials under seal is granted with respect to the full, unredacted version of the application and the full, unredacted version of the July 17, 2008 declaration of Shari Hollis-Ross in support of the application, to which the full, unredacted version of the Settlement Agreement is attached as Exhibit 1. The aforesaid materials are placed under seal for a period of two years from the effective date of this decision, through and including December 6, 2010, and during that period the material so protected shall not be made accessible or disclosed to anyone other than Commission staff except upon the further order or ruling of the Commission, the assigned Commissioner, the assigned Administrative Law Judge (ALJ), or the ALJ then designated as Law and Motion Judge. If PG&E believes that further protection of the aforesaid materials is needed after December 6, 2010, then PG&E may file a motion stating the justification for further withholding of these materials from public inspection, or for such other relief as the Commission's rules may then provide. Such a motion shall explain with specificity why the designated materials still need protection in light of the passage of time involved, and shall attach a clearly identified copy of the ordering paragraphs of this decision to the motion. Such a motion shall be filed at least 30 days before expiration of the protective order set forth in this paragraph.

4. Application 08-07-028 is closed.

This order is effective today.

Dated ______________________________, at San Francisco, California.