STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

May 22, 2002

June 27, 2002
Agenda ID #671
(Alternate Order Agenda ID #670)

TO: PARTIES OF RECORD IN A.01-09-027

Enclosed are Agenda ID #670 and Agenda ID #671, the Alternate Proposed Decision of Commissioner Wood to the Draft Decision of Administrative Law Judge (ALJ) Wong. The Alternate, and the ALJ's Draft Decision, are enclosed.

When the Commission acts on an agenda item, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

As set forth in Rule 77.6, parties to the proceeding may file comments on the Alternate of Commissioner Wood at least seven days before the Commission meeting or no later than June 20, 2001. Reply comments should be served by June 24, 2002. An original and four copies of the comments and reply comments with a certificate of service shall be filed with the Commission's Docket Office and copies shall be served on all parties on the same day of filing. The Commissioners and ALJ shall be served separately by overnight service.

/s/ CARL OSHIRO
Carl Oshiro, Interim Chief
Administrative Law Judge

CKO: mnt

Enclosures

COM/CXW/mnt **ALTERNATE DRAFT**

Agenda ID #671
(Alternate order to ID # 670)
6/27/02

Decision **ALTERNATE PROPOSED DECISION OF COMMISSIONER WOOD**
Mailed 5/22/02

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 338-E) for Order Approving Proposed Settlement Agreement Regarding QFID 2180 and Authorizing Edison's Recovery of Payments Made Under the Proposed Settlement Agreement Between Edison and the County of Los Angeles.	Application 01-09-027 (Filed September 19, 2001)

OPINION REGARDING PITCHESS HONOR RANCHO COGENERATION FACILITY

Summary

Southern California Edison Company (SCE) requests that the Commission ensure that it can recover from ratepayers certain payments that it has agreed to make to the County of Los Angeles (County) regarding the County's cogeneration facility at the Pitchess Honor Rancho prison located in Saugus, California. SCE would make these payments to resolve certain disputes about the firm capacity performance requirements contained in the qualifying facility (QF) contract between SCE and the County.

Today's decision rejects the application as unnecessary and finds that SCE otherwise failed to meet its burden of demonstrating that the payments that it has agreed to make to the County are reasonable.

Background

SCE and the County entered into a power purchase contract on November 5, 1985, using a Commission-approved standard form QF contract, commonly referred to as a Standard Offer No. 2. The contract provides that SCE will purchase energy from the County's cogeneration facility. The length of this contract is for 30 years. The County's cogeneration facility became operational in July 1988, and was declared to be in "firm operation" under the terms of the contract in November 1988.[1]

Under the contract, the County elected to provide SCE with 22.204 megawatts (MW) of firm capacity (contract capacity) in exchange for a capacity price of $165 per kilowatt per year. Section 6.1 of Appendix B.2 of the contract provides that the County will receive full capacity payments only if it delivers the contract capacity during the on-peak hours in each peak month, subject to a 20% monthly allowance for forced outages. Under Section 8 of Appendix B.2 of the contract, if the County does not meet the minimum

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[1] The contract was first amended on July 31, 1987. The contract was amended for a second time shortly after the Commission approved some QF amendments in Decision (D.) 01-07-031, including the approval of Amendment No. 2 to the QF contract between SCE and the County. A draft of Amendment No. 2 was attached to Tab 1 of SCE's June 13, 2001 motion that was filed in R.99-11-022, and which was approved in D.01-07-031. According to Section 3.2.4 of that draft Amendment No. 2, "all issues between Edison and Seller [County] arising from (a) Edison's non-payment for electricity delivered by Seller from November 1, 2000 through and including March 26, 2001, (b) Seller's performance or non-performance under the Contract from January 1, 2001 through and including the Effective Date, to the extent such performance or non-performance was caused by the factors identified in Seller's declaration under penalty of perjury as provided for in Section 3.2.5 below, and (c) Seller's payment or non-payment of amounts owing to Edison under the Contract or otherwise shall be resolved."

performance requirement in Section 6.1, and its performance is not excused by an uncontrollable force as defined in Section 4.33 of the contract, the County may be placed on probation for a period not to exceed 15 months. If the County fails to demonstrate that it can deliver contract capacity during this probationary period, Section 8.1.3 of Appendix B.2 provides that the contract capacity may be derated to the greater of the level of capacity actually delivered during the probationary period or the capacity level that the County is reasonably likely to meet. In the event of a derating of contract capacity, Section 8.1.3 of Appendix B.2 and Section 5.5 provide that the County would owe SCE a capacity overpayment refund. If the failure to perform is excused by an uncontrollable force, then SCE is obligated to continue the County's capacity payments for up to 90 days and the County would not be subject to probation and derating.

The disputes that are the subject of the agreement between SCE and the County focus on whether the County should be excused from meeting the contract's firm capacity performance requirements in July and August 1999 because of certain alleged uncontrollable force events.[2] These events include the failure of a steam turbine at the facility and subsequent delays by a third-party contractor in making the required repairs to the turbine. SCE contends that the County had failed to carry its burden of establishing the existence of uncontrollable forces and reduced the County's capacity payments for the two months in question. The County argues that SCE had improperly rejected the County's claims of uncontrollable forces, and that SCE had underpaid the

[2] The various disputes and the negotiations leading up to the settlement are described in more detail in the "Prepared Testimony and Qualifications of Lars E. Bergmann and Cathy L. Mendoza" (prepared testimony).

County $788,501.31 for capacity delivered in July and August 1999, and for winter bonus payments during the period from October 1999 through May 2000.

SCE and the County also dispute whether SCE had properly instituted a probationary period when the County did not meet its performance requirements in July 1999. They dispute whether it was appropriate for SCE to derate the project from 22.204 MW to 10.325 MW[3] when the utility concluded that the County failed to demonstrate its ability to deliver the contract capacity during the first month of the probationary period in August 1999. SCE began offsetting against the payments for deliveries from October 2000 through part of January 2001. The offset was to collect the capacity overpayment refund obligation that SCE calculated as being equal to $7,150,579.95 as of October 1, 2000.

SCE and the County initially began negotiations to settle the dispute in September 2000. However, these negotiations were unsuccessful and no agreement was reached.

During the time of the ongoing dispute between SCE and the County, wholesale electric rates in California began to rise dramatically. According to SCE, it continued to meet customer demand by procuring power at exorbitant rates. However, SCE was unable to pass these costs through to customers because SCE's authorized rates were lower than the prevailing wholesale rates. This resulted in a severe cash flow problem for SCE, and impaired its ability to borrow funds.

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[3] The derating became effective on October 1, 2000.

SCE filed a petition and two motions before the Commission in which it asserted that a number of factors were causing short-run avoided cost (SRAC) energy prices, including those provided for in the contract with the County, to exceed the avoided cost limits imposed by federal law. As a result of a combination of these factors, SCE suspended payments to QF generators and other creditors beginning in late December 2000. Consequently, SCE did not make payments to QFs for energy deliveries in November through March 26, 2001.

In D.01-03-067, we agreed that the formula for calculating SRAC prices was flawed, and modified the formula as of April 1, 2001. In that decision, we also ordered SCE to resume payments to the QFs for deliveries on and after March 27, 2001. SCE continued to contest the lawfulness of the SRAC prices for the period from November 2000 through March 26, 2001.[4]

During this time of turmoil in the energy markets, SCE and the County held further settlement discussions. They subsequently entered into a settlement agreement which became effective on July 5, 2001.

The terms of this agreement are contained in the "Settlement Agreement Between County of Los Angeles (Pitchess Honor Rancho, QFID 2180) and Southern California Edison Company." The settlement agreement, as well as an unredacted copy of the application and an unredacted copy of the prepared testimony were filed under seal. SCE also filed redacted copies of the application and the prepared testimony, and the full version of the contract and amendment between SCE and the County. When SCE filed these public and non-public

[4] See footnote 1.

pleadings, it also filed a motion for a protective order to keep the settlement agreement and the confidential and sensitive information in the application and the prepared testimony sealed. In a ruling dated October 17, 2001, the assigned ALJ granted SCE's motion to keep those materials under seal, and to limit access to the non-public version of those documents.

SCE seeks Commission approval of the terms of the agreement as reasonable, and asks that it be authorized to recover all payments made or to be made by SCE to the County pursuant to the settlement agreement, subject only to SCE's prudent administration of the settlement agreement and the QF contract between SCE and the County.

Notice of the filing of SCE's application was published in the Commission's Daily Calendar on September 27, 2001. No one filed any protest or response to the application, and no evidentiary hearings were held.

Settlement Agreement

According to the public version of SCE's application, the principal terms of the parties' settlement are memorialized in the agreement that was filed under seal. The non-public version of the application describes the principal terms of the agreement, and contains a discussion as to why SCE believes the agreement is reasonable. Neither the public nor non-public version of the prepared testimony discuss the terms of the settlement. Instead, the prepared testimony is limited to a description of the QF contract, the disputes, the events surrounding the energy crisis in California, and the events leading to the negotiations and eventual settlement of the disputes.

In order to determine what is provided for in the settlement, we reviewed the non-public settlement agreement, and the public and non-public versions of the application and the prepared testimony, as well as the QF contract and the

amendments. The following discussion of the issues is based on our review of the settlement agreement, and the other pertinent documents.

Discussion

It is not clear why SCE is seeking our approval of this agreement. Frequently, we review QF contract modifications, but there is no modification offered here. We are only asked to review a commitment to pay funds to a QF in a manner that is consistent with the existing contract. Often, we consider adopting settlements of disputes related to proceedings pending before this Commission, but there was no pending proceeding which the agreement is intended to settle. It appears that the only role the Commission has to play, here, is to provide SCE with extraordinary assurance that a specific portion of its QF costs are recoverable.

If SCE had concluded, from the outset, that the County had met its performance obligations or was excused from non-performance due to an "uncontrollable force," SCE presumably would have committed to pay for the full capacity value without first seeking our permission. As a party to many contracts with QFs, this is the kind of decision SCE makes every day. It would be impractical for SCE to run to the Commission for advice each time it is ready to write a check and it would be inappropriate to encumber the Commission's limited resources in this way. In this instance, SCE first concluded that it should not make certain payments. Now, to the extent described in confidential documents, it has changed its mind – either because it is now convinced that the County deserves to be paid, or because it has concluded that it is unlikely to prevail in court.

Perhaps if SCE demonstrated that it stood to save ratepayers significant sums by pursuing litigation, there might be a need to provide SCE with the

protection of a reasonableness finding if, for some other reason, it were still more appropriate to "settle." However, SCE offers little evidence to suggest that it might prevail in court. Instead, SCE presents numerous reasons that it might lose. If this evidence presents a complete picture of litigation risk, then why go to court? Why raise any questions about the treatment of the QF? Why encumber the resources of this agency in reviewing these payments? We should not encourage SCE to file applications of this type by providing the relief it seeks, here.

Even if there were reason to adjudge these payments, we could not do so on the basis of the showing offered by the utility. SCE has not quantified the value of its payments. While part of the agreement involves a specific cash payment, another part of the agreement involves further payments based on a formula. We do not know the magnitude of those payments, and therefore cannot assess the comparative value of the choices with which we would be faced.

SCE argues that the Commission should review this arrangement as a settlement, and approve it if it falls "clearly within the range of possible outcomes had the parties fully litigated the dispute." However, what SCE refers to as a settlement here, is not the settlement of a matter pending before this Commission. The Commission's standards for reviewing such settlements are irrelevant. What SCE is seeking is a guarantee of shareholder protection for contractual payments it seeks to make to a specific QF. SCE bears the burden of demonstrating that it is appropriate for the Commission to provide such a guarantee and that the payments, in this instance, are reasonable. SCE has not met either burden. Thus, we deny SCE's request for approval of the agreement and guaranteed rate recovery.

Comments

The alternate proposed decision of Commissioner Wood in this matter was mailed to the parties in accordance with Pub. Util. Code §311(g)(1) and Rule 77.6 of the Rules of Practice and Procedure. Comments were filed by _____, and reply comments were filed by _____.

Findings of Fact

1. SCE and the County entered into a Standard Offer No. 2 QF contract on November 5, 1985.
2. The County provides SCE with firm capacity under the contract.
3. Certain disputes about the contract regarding the County's firm capacity performance, uncontrollable force events, the institution of a probationary period, and payment offsets arose in 1999 and 2000.
4. SCE and the County reached a settlement of these issues, which became effective on July 5, 2001.
5. The proposed settlement is the central focus of SCE's application, and did not arise as a result of an ongoing proceeding.
6. The Commission has reviewed the QF contract and amendments, the circumstances giving rise to the settlement, and the terms of the proposed settlement.
7. The settlement resolves the monetary claims and issues in dispute about uncontrollable force, the probationary period, and derating of the project.
8. SCE has not met its burden of proving why the Commission should review this agreement or why the resulting payments are reasonable.

Conclusions of Law

1. The Commission's settlement rules do not apply to this application.
2. The relief requested in this application should be denied.

O R D E R

IT IS ORDERED that:

1. The request of the Southern California Edison Company (SCE) for approval of its agreement with the County of Los Angeles (County) pertaining to the Pitchess Honor Rancho cogeneration facility is denied.
2. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.