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Decision 01-10-069 October 25, 2001

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs.	Application 00-11-038 (Filed November 16, 2000)
Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E)	Application 00-11-056 (Filed November 22, 2000)
Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527.	Application 00-10-028 (Filed October 17, 2000)
Order Instituting Rulemaking into Implementation of Public Utilities Code Section 390.	Rulemaking 99-11-022 (Filed November 18, 1999)

OPINION REGARDING SOUTHERN CALIFORNIA EDISON COMPANY'S PETITION FOR MODIFICATION OF DECISION 01-09-021

I. Summary

On September 14, 2001, Southern California Edison Company (SCE) filed a petition for modification (Petition) of Decision (D.) 01-09-021. In that decision, the Commission granted the Independent Energy Producers Association's (IEP) petition for modification of D.01-06-015 which requested that the reference to the date of July 15, 2001, found at page 4 of D.01-06-015, be extended to July 31, 2001.

July 15, 2001 was the date set by that decision for three types of contract modifications to the contracts of qualifying facilities (QFs) which would be "deemed reasonable"[1] if the modification was "made prior to July 15, 2001." SCE's Petition seeks to extend the safe harbor date from July 31, 2001 through and including the close of business on September 6, 2001.

Today's decision denies SCE's Petition. SCE and the other utilities are free to file applications with the Commission seeking approval of QF contract amendments that were entered into after July 31, 2001. This decision modifies Ordering Paragraph 2.b. of D.01-09-021 to make the reporting date consistent with Ordering Paragraph 5 of that decision.

II. Background

D.01-06-015 was issued to help bring stability to the electricity supply contracts entered into between the utilities and the QFs. In order to "ensure that QFs generate as much electricity as reasonably possible, and at reasonable prices," the Commission preapproved three types of contract modifications in D.01-06-015, which the Commission viewed as providing incentives to maximize QF production. The Commission stated in D.01-06-015 that these three types of contract modifications "which are made prior to July 15, 2001 are deemed reasonable by the Commission."

The three non-standard contract modifications that D.01-06-015 would find reasonable are: (1) replacing the standard Short Run Avoided Cost (SRAC) formula with a fixed price for five years of 5.37 cents/kWh; (2) allowing supplemental payments to be made to QFs above the specified SRAC for up to

[1] SCE refers to the deemed reasonable date as a "safe harbor."

one year for QFs that demonstrate to the Commission's Energy Division that the current SRAC is insufficient to recover the QF's actual fuel costs for producing electricity; and (3) providing incentive payments for QFs to increase generation above their normal operating levels based on the terms specified in D.00-08-022, as clarified in D.01-06-015.

Following the July 13, 2001 filing of IEP's petition to modify D.01-06-015, an Administrative Law Judge's (ALJ) ruling was issued on July 19 which addressed the July 15, 2001 date set forth in D.01-06-015. The ALJ ruling extended the July 15, 2001 safe harbor date until the Commission could consider IEP's petition to modify D.01-06-015. The ruling also shortened the time for parties to respond to IEP's petition to modify.

On September 4, 2001, the California Cogeneration Council (CCC) filed a motion for leave to file supplemental comments to IEP's petition to modify D.01-06-015. CCC's supplemental comments identified one contract amendment with a QF that had been entered into after July 31, 2001. The supplemental comments also stated that a number of other agreements between the utilities and the QFs had been entered into after July 31, 2001. The CCC requested that the safe harbor date be extended through September 6, 2001. SCE filed a response to CCC's response that same day in support of extending the safe harbor, but requested that it be extended through September 13, 2001. IEP's petition to modify D.01-06-015 was granted in D.01-09-021, which was adopted on September 6, 2001. However, D.01-09-021 only extended the safe harbor provision through July 31, 2001.

SCE states in its Petition that because of the July 19 ruling, some negotiations for contract modifications between the utilities and qualifying facilities took place for several weeks beyond July 31, and that a number of

contract amendments and other agreements were executed by SCE after that date.

SCE's Petition requested that the Commission expedite consideration of its Petition at the September 20, 2001 meeting. Since the Commission did not add SCE's Petition to the September 20 meeting agenda, SCE filed a motion on September 21, 2001 for an order shortening time for interested parties to file a response to SCE's Petition in the hope that the Commission would act on the Petition at the October 11, 2001 meeting.[2] An ALJ ruling granted SCE's motion to shorten the time on September 25, 2001. The CCC, Chevron U.S.A. Inc. (Chevron) and the Office of Ratepayer Advocates (ORA) filed responses to SCE's Petition. SCE filed a reply to ORA's response.

III. Position of the Parties

A. SCE

SCE contends that the agreements that it executed after July 31, but before September 6, are consistent with the guidelines established in D.01-06-015, as clarified in D.01-07-031. SCE states that by failing to extend the safe harbor provision to a later date, the Commission has effectively directed that the review and approval of these agreements take place through the application process, which is usually a time consuming exercise. In addition, SCE points out that some of these contracts entered into after July 31 terminate automatically if the Commission does not approve them by certain prescribed dates.

[2] The October 11, 2001 Commission meeting was subsequently rescheduled to October 10, 2001.

SCE also contends that the agreements entered into after July 31 advance the policy objective in D.01-06-015 of protecting ratepayers against price volatility. The volatility of recent energy markets, the unpredictability of future market-based energy pricing, and the unique circumstances over the last several months, all favor extending the safe harbor to include agreements executed after July 31 which meet the Commission's guidelines.

Due to the July 19 ruling, SCE argues that due process and fairness require that the safe harbor date be extended through September 6, 2001, the date when the Commission considered IEP's petition to modify D.01-06-015. SCE argues that the "July 19 ruling clearly advised parties that the safe harbor would be extended beyond July 31, 2001" in the event the Commission had not acted on IEP's petition to modify. In reliance thereon, SCE and others construed the ruling to mean that executed agreements consistent with the guidelines in D.01-06-015 would be deemed reasonable through and including the date that the Commission acted on or considered IEP's petition to modify.[3] SCE contends that D.01-09-021 confirmed this interpretation when the Commission stated that the July 19 ruling extended the July 15 cutoff date "until the Commission could consider" IEP's petition.[4]

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[3] SCE points out in its reply that ORA did not dispute that parties reasonably relied on the July 19 ruling.

[4] SCE also argues that in D.01-09-027, a decision denying rehearing of D.01-06-015 and which was considered on the same day as D.01-09-021, confirmed that the July 19 ruling extended the July 15 date until the Commission could consider IEP's petition to modify D.01-09-021.

B. CCC

The CCC filed a response in support of SCE's Petition. The CCC also urges the Commission to take action at the October 10, 2001 meeting due to the automatic expiration of a number of the amended contracts, and because of changing market conditions.

The CCC states that in reliance on the July 19 ruling, a number of QFs continued their negotiations and entered into contract amendments with the utilities after July 15, 2001. Twenty-one QF contracts were entered into between the QFs and SCE after July 31 and before September 6. Nine contract amendments were entered into between the QFs and Pacific Gas and Electric Company (PG&E) during the same period. Twelve of the 21 amended contracts with SCE account for about 109 MW, with 52 MW from renewable technology and the remaining 57 MW from gas-fired QFs. The nine contract amendments with PG&E account for about 340 MW, all of which is from gas-fired QFs.

The CCC asserts that the approval of all of these contract amendments are in the best interest of the ratepayers for several reasons. First, these contract amendments will reduce the exposure of electricity ratepayers to the volatile spot market price of natural gas. The 5.37 cents/kWh is a reasonable five-year price for QF energy, and is substantially lower than the average SRAC energy price for both SCE and PG&E during the past year. The CCC contends that although last year's spot gas prices, which affects the SRAC price, were unusually high, no one knows what prices will be like over the next five years. The CCC also argues that the 5.37 cents/kWh is also recoverable within the utilities' existing rate structure, and that there will be no need to increase electricity rates or to modify the existing rate structure. The 5.37 cents/kWh will also help keep gas-fired QFs on line during this time of extreme market instability. The CCC also states that the

QFs are a highly reliable source of electricity with high capacity factors, and that because of their geographic diversity and fuel diversity, these plants are less susceptible to localized natural disasters and outages, while promoting fuel conservation and energy efficiency.

The CCC's second reason for extending the safe harbor date is that approval of the amendments will help resolve pending bankruptcy and other litigation issues as well as other Commission proceedings. The CCC states that in each of the amended contracts with SCE, there is a provision that precludes the QFs from filing an involuntary Chapter 11 petition against SCE. The CCC asserts that such a provision will significantly reduce the risk of SCE's bankruptcy. For the PG&E amendments, the CCC states that all of those amendments are tied to the broader power purchase contract assumption agreements. Upon approval of the amendments, PG&E will assume the underlying power purchase agreements, and the QFs will defer collection of back payments to the future. In addition, a number of breach of contract and other claims will be resolved as well under the assumption agreements. The CCC also states that approval of the amendments will also lead to the resolution of several proceedings pending before the Commission, which will save all parties from litigating these issues.

The CCC's third reason for extending the safe harbor date is that when D.01-09-021 was issued, the Commission was aware that a number of QFs and the utilities had relied on the July 19 ruling and executed amendments after July 31, 2001. Due to their reliance of the ruling, the CCC states that the only responsible course of action for the Commission is to extend the safe harbor date.

The CCC's fourth reason for extending the safe harbor date is that the 5.37 cents/kWh will not create a windfall for gas-fired QFs. The CCC

acknowledges that gas-fired QFs will make a profit under the 5.37 cents/kWh energy price, but that the profit margin will be slim. CCC states that the Commission should focus on whether ratepayers will sufficiently benefit from the amendments rather than the amount that the QFs will earn.

C. Chevron

Chevron supports SCE's Petition to extend the safe harbor date. Chevron argues that that the July 19 ruling extending the safe harbor date until the Commission could consider IEP's petition to modify D.01-06-015 was clear and unequivocal, and that the Commission should not undermine the ALJ's ruling. The utilities and the QFs relied on this ruling and continued negotiations in good faith to conclusion. Chevron asserts that the "Commission's action in D.01-09-021 unfairly and inappropriately violates the parties justified reliance on the extension reflected in the July 19 Ruling."

Chevron also contends that the policy objectives which formed the basis for the per se reasonable QF contract amendments also apply to contract amendments that were executed between July 31, 2001 and September 6, 2001. These post-July 31 contract amendments bring stability to the electricity supply, and ensures that QFs generate as much electricity as possible and at reasonable prices.

In order to ensure that QF electricity production is maximized, Chevron asserts that the Commission must extend the safe harbor date for both SCE and PG&E.

D. ORA

ORA contends that SCE's Petition should be denied because not all of the contractual terms set forth in D.01-06-015 can be considered reasonable in today's gas market. ORA asserts that current market conditions demand that

contract modifications entered into after July 31, 2001 reflect "more realistic and universally beneficial 'preapproved' contractual terms."

ORA points to the decrease in natural gas prices between June and September of this year. This decrease means that the contract modification of a fixed price for five years at 5.37 cents/kWh will no longer generate short- or long-term savings. ORA asserts that when D.01-06-015 was issued, the Commission sought to compensate QFs for abnormally high gas prices and to encourage off-line QFs to resume operation. However, due to the drop in gas prices, there are no longer any short-term savings, nor does such a modification protect against price volatility for the next five years. Instead of contracts for a term of five years, ORA states that the 5.37 cents/kWh fixed priced contracts should be for terms ranging from 24 to 42 months, and that the previously adopted preapproved contractual terms in D.01-06-015 should be modified to reflect this.

ORA also contends that the QF portfolio should be diversified in light of the drop in gas prices. Instead of having a portfolio with a large number of five-year contracts at 5.37 cents/kWh, there should be other fixed price agreements with varying expiration dates to alleviate the risk of locking in all QF contracts for a term of five years.

E. Discussion

Before addressing the merits of SCE's Petition, we note that SCE mentions in footnote 1 of its Petition that D.01-09-021 did not refer to CCC's September 4, 2001 motion for leave to file supplemental comments, the

supplemental comments of CCC, or to SCE's response to CCC's motion.[5] Due to the timing of CCC's motion and SCE's response to the motion, both of which were not filed with the Commission until two days before the Commission voted on IEP's petition to modify D.01-06-015, there was insufficient time to reference those various pleadings in D.01-09-021. However, when this agenda item was voted on to be added to the September 6 agenda, and during the introduction of this agenda item, the Commissioners specifically noted that the CCC had filed its motion and that there was an urgent need to act on the IEP's petition to modify.

Since a ruling has not yet issued on CCC's motion for leave to file its supplemental comments, we will grant CCC's motion, and direct the Docket Office to file the supplemental comments of CCC as of September 4, 2001.

SCE seeks to extend the safe harbor provision due to two reasons. The first is that the utilities and the QFs relied on the July 19, 2001 ruling which stated that the July 15, 2001 date would be extended until the Commission could act on IEP's petition to modify D.01-06-015. The second reason is that SCE asserts that the contract modifications entered into after July 31, 2001 are consistent with the contract modifications deemed reasonable in D.01-06-015, as clarified in D.01-07-031. Chevron's response also support SCE's reasons for changing the safe harbor date.

We recognize that the July 19, 2001 ALJ ruling stated that the "July 15, 2001 date set forth at page 4 of D.01-06-015 shall be extended until the Commission has an opportunity to consider" the IEP's petition for modification of D.01-06-015. However, the utilities and QFs were also aware that the IEP's

[5] The CCC also noted this in its response.

petition for modification only requested that the safe harbor provision be extended to July 31, 2001. It was not until the filing of the CCC's motion for leave to file supplemental comments that a request to extend the safe harbor date to September 6, 2001 was made. In addition, the Commission had also adopted D.01-07-031, a decision clarifying D.01-06-015. D.01-07-031 was adopted at the July 12, 2001 Commission meeting, one week before the July 19 ruling, and one day before IEP filed its petition to modify D.01-06-015. D.01-07-031 specifically stated as follows:

> "[T]he blanket preapproval of the specific contract amendments discussed in D.01-06-015 is limited to amendments executed no later than July 15. So, the utility may be at risk in subsequent reasonableness reviews for execution of amendments made after July 15. We are not persuaded that an extension of the deadline is required at this time." (D.01-07-031, p. 3.)

Neither SCE, nor any of the parties who filed responses to SCE's Petition, mentioned this passage from D.01-07-031.

There is no language in D.01-06-015 which prevents the utilities and QFs from negotiating contract amendments after July 31, 2001. Indeed, in D.01-07-031, the Commission noted that:

> "… D.01-06-015 does not preclude amendments being executed after July 15, 2001. QFs and utilities may continue to negotiate and execute contract amendments at any time."

Although amendments entered into after July 31, 2001 are not automatically deemed reasonable, the utilities are still able to seek Commission approval of these contract amendments by filing an application for approval of the modified contract. Both SCE and the CCC note that if the safe harbor provision is not extended beyond July 31, 2001, that any agreements negotiated

after that date will have to be approved by the Commission through the filing of a new application.

ORA's response points out that due to the drop in gas prices, the five-year fixed price of 5.37 cents/kWh, which was approved in D.01-06-015, is now too high of a price to pay for market stability. The CCC asserts that the 5.37 cents/kWh will not result in a windfall to gas-fired QFs, and that the price represents a reasonable five-year price for QF energy.

We first note that no one can accurately predict what gas prices will be over the next five years. Second, when D.01-06-015 established the safe harbor date of July 15, 2001, the Commission felt some sense of urgency for deciding that amendments executed prior to this date should be deemed reasonable. The Commission refused to extend the safe harbor date in D.01-07-031, but said that the QFs and utilities could continue to negotiate and execute contract amendments at any time. It is clear that the Commission was cognizant of changing market conditions, and did not want to deem reasonable contract amendments entered into after a certain date. The recent drop in gas prices reflects a change in market condition, and the utilities and the QFs should seek approval of these amendments through the application process rather than have the amendments automatically deemed reasonable.

As for the CCC's argument that approval of these additional contract amendments will help resolve pending bankruptcy and other litigation issues, the same result can be achieved by having the utilities and the QFs file these contract amendments for approval in one or more applications. Due to PG&E's bankruptcy proceeding, PG&E's proposed resolution of its financial affairs, and the settlement between this Commission and SCE, we do not believe that

extending the safe harbor date will necessarily speed up the resolution of these other legal matters.

Based on our reasoning above, neither SCE nor any of the other parties have raised arguments which compel us to extend the safe harbor date beyond July 31, 2001. Accordingly, SCE's petition to modify D.01-09-021 is denied.

It has come to our attention that Ordering Paragraph 2.b. of D.01-09-021 referred to the date of October 12, 2001, and that this reference is inconsistent with Ordering Paragraph 5 of D.01-09-021. The reference to "October 12, 2001" in Ordering Paragraph 2.b. of D.01-09-021 should have been to "July 31,2001, or as directed by the Commission…." Ordering Paragraph 2.b of D.01-09-021 should be modified accordingly.

F. Waiver of Comments

Public Utilities Code § 311(g)(1) generally requires that the Commission's draft decision be served on all parties, and subject to at least 30 days of public review and comment prior to a vote of the Commission. Rule 77.7(f)(9) provides that the Commission may reduce or waive the period for public review and comment where the Commission determines "that public necessity requires reduction or waiver of the 30-day period for public review and comment." That subdivision provides that the term " 'public necessity' refers to circumstances in which the public interest in the Commission adopting a decision before expiration of the 30-day review and comment period clearly outweighs the public interest in having the full 30-day period for review and comment."

The time for public review and comment on this decision should be waived. SCE's September 21 motion to shorten time emphasized the need for action at the October 11, 2001 Commission meeting[6] because of a perceived need to act on a number of QF contract amendments that would expire on or about October 13 if the Commission fails to act. Since the September 25 ruling gave interested parties until October 3 to file a response to SCE's Petition, and gave SCE to October 9 to file a reply, there is no time left for public review and comment if the Commission is to act on October 10, 2001. Therefore, the public necessity of acting on this decision in a timely manner outweighs the public's interest for review and comment.

Findings of Fact

1. D.01-09-021 extended the safe harbor date from July 15, 2001 to July 31, 2001.

2. D.01-06-015 was adopted to help bring stability to the electricity supply contracts entered into between the utilities and the QFs.

3. D.01-06-015 preapproved three types of contract modifications, which if made on or before the safe harbor date, would be deemed reasonable by the Commission.

4. Some contract modifications between the utilities and QFs took place after July 31, 2001, and some contract amendments were executed after that date.

5. SCE has requested that the Commission expedite consideration of its Petition.

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[6] See footnote 2.

6. D.01-09-021 did not reference the CCC's September 4, 2001 motion for leave to file supplemental comments and SCE's response to that motion because those pleadings were not filed until two days before the Commission adopted D.01-09-021.

7. The Commissioners acknowledged the filing of CCC's September 4, 2001 motion during the Commission meeting of September 6, 2001.

8. Although the July 19 ruling stated that the July 15, 2001 date shall be extended until the Commission has an opportunity to consider the IEP's petition for modification of D.01-06-015, the utilities and QFs were also aware that the IEP's petition for modification only requested that the safe harbor provision be extended to July 31, 2001.

9. In D.01-07-031, which clarified D.01-06-015 and which was adopted one week before the July 19 ruling and one day before IEP's petition for modification of D.01-06-015, stated that the utility may be at risk for execution of amendments made after July 15.

10. There is nothing in D.01-06-015 which prevents the utilities and QFs from negotiating contract amendments after July 31, 2001.

11. The utilities are free to seek Commission approval of the contract amendments entered into after July 31, 2001 by filing an application with the Commission.

12. No one can accurately predict what gas prices will be over the next five years.

13. When D.01-06-015 established the safe harbor date of July 15, 2001, the Commission felt some sense of urgency for deciding that amendments executed prior to this date should be deemed reasonable.

14. Extending the safe harbor date to September 6, 2001 will not speed up the resolution of these other legal matters.

15. None of the parties have raised arguments which compel us to extend the safe harbor date beyond July 31, 2001.

16. The reference in Ordering Paragraph 2.b. of D.01-09-021 to the date of October 12, 2001 is inconsistent with Ordering Paragraph 5 of D.01-09-021.

17. SCE's September 21, 2001 motion to shorten the time to respond to its Petition emphasized the need for Commission action at the October 11, 2001 meeting because of a perceived need to act on a number of QF contract amendments that would expire on or about October 13 if the Commission fails to act.

18. The public interest in acting on SCE's petition to modify D.01-09-021 in a timely manner outweighs the public's interest for review and comment.

Conclusions of Law

1. The September 4, 2001 motion of CCC for leave to file its supplemental comments should be granted, and the Docket Office should be directed to file the supplemental comments as of September 4, 2001.

2. The Commission was cognizant of changing market conditions when it adopted D.01-06-015, and did not want to deem reasonable contract amendments entered into after a certain date.

3. Ordering Paragraph 2.b. of D.01-09-021 should be modified to eliminate the inconsistency with Ordering Paragraph 5 of that decision.

4. The time for public review and comment of the decision is waived.

O R D E R

IT IS ORDERED that:

1. The September 4, 2001 motion of the California Cogeneration Council (CCC) for leave to late file its supplemental comments to the Independent Energy Producers Association's petition for modification of Decision (D.) 01-06-015 is granted.

   a. The Commission's Docket Office is directed to file the supplemental comments of CCC as of September 4, 2001.

2. The September 14, 2001 petition for modification of D.01-09-021 filed by Southern California Edison Company is denied.

3. D.01-09-021 shall be modified as follows: the reference to "October 12, 2001" in Ordering Paragraph 2.b. of D.01-09-021 shall be replaced by the following phrase: "July 31, 2001, or as directed by the Commission…."

This order is effective today.

Dated October 25, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I will file a dissent.

/s/ HENRY M. DUQUE
Commissioner

I dissent.

/s/ RICHARD A. BILAS
Commissioner

Commissioner Henry M. Duque dissenting:

Item H-6 dissent

As an initial matter, I must state that I share the concerns expressed over the impact on ratepayers from these QF contracts. Yet I am even more concerned that fairness and due process be afforded all parties. The majority decision introduces uncertainty in our process in addition to undermining the meaning and credibility of Commission rulings. The July 19, 2001 administrative law judge (ALJ) ruling clearly advised the parties that the safe harbor for entering into contracts was extended beyond July 31, 2001. The ruling stated that the date "shall be extended until the Commission has an opportunity to consider" the petition to modify. The Commission then considered the petition on September 6, 2001. In another decision, the Commission further reiterated that there was no prohibition against contracts being executed after July 15, 2001. The parties clearly relied on these rulings and entered into contracts.

Illusive regulatory deadlines such as the one applied in the majority decision confuse the parties and ultimately undermine their confidence in acting on Commission direction.

The majority decision sends the message that the Commission can on a whim alter deadlines whether parties are relying or our rulings or not. I have serious reservations about this aspect of the majority decision because it establishes an unenforceable, ever-shifting standard that makes our process unreliable. A clear set of guidelines to the particular regulated industry is important. Equally important is to instill confidence in the authority that the Commission delegates to the ALJs under those guidelines.

For these reasons, I must dissent.

/s/ HENRY M. DUQUE

Henry M. Duque
Commissioner

October 25, 2001
San Francisco, California