Mailed 12 / 22 / 2000

Decision 00-12-059 December 21, 2000

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company for an Ex Parte Order Approving Settlement Agreements Between Pacific Gas and Electric Company and Certain Winning Bidders in Pacific Gas and Electric Company's Biennial Resource Plan Update Auction. (U-39-E)	Application 99-12-038 (Filed December 27, 1999)

TABLE OF CONTENTS

TITLE **PAGE**

OPINION....2
I. Summary....2
II. The Update....2
III. This Application....6
IV. Parties' Positions....8
A. PG&E and the Settling Parties....8
B. Aglet....9
V. Request for Supplemental Briefing....9
VI. Reasonableness of the Settlements....10
A. Standard of Review....10
B. The July ACR....11
C. Reasonable Bid Preparation Costs or Reliance Costs....12
D. The PG&E/AES Settlement....14
1. Costs incurred before PG&E declared AES a "winning bidder" in the Hunters Point auction....15
2. NOx Offsets....16
3. Letter of Credit Fees....16
4. Discounting of AES' costs....17
a) January 10, 1994, when PG&E announced AES as a winning bidder....18
b) April 20, 1994, when the Commission commenced electric industry restructuring efforts....19
c) February 23, 1995, when FERC concluded that the Update auction violated federal law....20
d) June 1995, when FERC denied reconsideration....21
e) July 5, 1995, when the July ACR issued....22
f) June 19, 1996, when the San Francisco Board of Supervisors urged the mayor and all city agencies to refrain from action that would result in development of the AES project....23
VII. The Effect of California's Current Capacity Need on this Proceeding....23
Comments to the Draft Decision....26
Findings of Fact....26
Conclusions of Law....29
ORDER....31

O P I N I O N

I. Summary

This decision addresses the application of Pacific Gas and Electric Company (PG&E) requesting that the Commission approve as reasonable the package of settlements it has achieved with certain bidders in the Biennial Resource Plan Update (Update) auction. The aggregate principal amount of the settlement package is $ 9,525,000. We find that PG&E's settlement package is reasonable, consistent with the law, and in the public interest, and approve it.

II. The Update

In this application, PG&E requests approval of a settlement package consisting of three settlements it has reached with certain bidders in PG&E's Update auction.[1] In order to place this application in context, we set forth a brief summary of the Update.

In the late 1980s, the Commission was in the practice of reviewing the utilities' resource planning activities. On July 7, 1989, the Commission issued Order Instituting Investigation 89-07-004, which officially established the Update proceeding as the forum for reviewing the utilities' long-term resource plans during a designated planning period and addressing generic issues related to utility purchases of electricity from a broad class of nonutility energy producers

[1] On May 23, 2000, the Administrative Law Judge (ALJ) issued a protective order placing the amount of the individual settlements as well as the settling parties' individual cost information under seal for a limited period, because of the commercial and proprietary nature of the cost information, and because disclosure of the individual settlement amounts could adversely affect PG&E's ability to negotiate effectively with the settling parties in the event the Commission does not approve the settlements.

called qualifying facilities or QFs.[2] (See Decision (D.) 92-04-045, 44 CPUC2d 6, 22.) For each utility, the Commission specified a certain amount of capacity and the benchmark prices for that capacity to be offered for possible deferral through QF bidding. For PG&E, the Commission designated two identified deferrable resources: (1) the repower of Hunters Point Units 2 and 3 for a total of 221 megawatts (MW) net capacity, and (2) a variable speed wind project of 22.5 MW effective capacity (150 MW gross capacity). (See 44 CPUC2d at 15 and 37.)

In the fall of 1993, PG&E commenced its solicitation in the Update in compliance with our orders. On December 9, 1993, Southern California Edison Company (Edison) suspended its solicitation, informed the Commission of unanticipated bidding strategies, and reargued the wisdom of a number of policy implementation methods we had previously determined (*e.g.*, second price auction, renewable set-aside). In response to PG&E's request for guidance regarding some of the same unanticipated bidding strategies raised by Edison, we issued D.94-01-020, 53 CPUC2d 35, where we directed PG&E to announce its auction winners for its Hunters Point solicitation as scheduled, because its request for guidance did not encompass this solicitation. We also directed PG&E not to announce the Final Standard Offer 4 (FSO4)[3] auction winners for its wind solicitation until further order from the Commission. Several days after

[2] 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.

[3] The Final Standard Offer 4 contract was a standard offer contract where the pricing was derived from the utility's long-run marginal costs. These costs were determined from the respective utility's resource plan.

D.94-01-020 issued, PG&E designated AES Pacific, Inc. (AES) as the winning bidder in its Hunters Point solicitation.

In June 1994, we issued D.94-06-047, 55 CPUC2d 274, which modified portions of the FSO4 solicitation to address unanticipated bidding strategies and recommenced the solicitation schedule. In June 1994, we also issued D.94-06-050, 55 CPUC2d 291, which denied PG&E's motion that the Commission immediately suspend its Hunters Point solicitation while the Commission considered the remaining Update solicitation in light of its recently initiated rulemaking and investigation on electric industry restructuring. The Commission later stayed D.94-06-047, but not D.94-06-050, on its own motion in D.94-10-039, 56 CPUC2d 620.

A number of parties filed applications for rehearing or petitions to modify the June 1994 decisions. These pleadings culminated in D.94-12-051, 58 CPUC2d 300, which denied a petition by PG&E to modify D.94-06-047 and D.94-06-050 with respect to the Hunters Point solicitation, but granted a limited rehearing at the request of Flowind Corporation in order to review and determine the as-available wind bidders. The Commission also lifted the stay it issued in D.94-10-039, and (except for the Hunters Point solicitation) required PG&E to negotiate additional terms and to submit FSO4 contracts to the Commission for approval by advice letter filing.

Following the issuance of D.94-12-051, Edison and San Diego Gas & Electric Company (SDG&E) filed petitions for enforcement with the Federal Energy Regulatory Commission (FERC) challenging the Commission's reinstatement of the solicitation, seeking to enjoin the implementation of our orders and to be relieved from having to enter into contracts with the bidders designated as "winning bidders."

On February 23, 1995, FERC issued an *Order on Petitions for Enforcement Action Pursuant to Section 210(h) of PURPA* in Docket Nos. EL95-16-000 and EL95-19-000 (February 23 FERC Order).[4] FERC ruled that this Commission's implementation of the Update violated PURPA and FERC's implementing regulations because this Commission did not consider all sources of electric capacity in setting avoided cost prices. The FERC concluded:

> "Because the California Commission's procedure was unlawful under PURPA, Edison and San Diego cannot lawfully be compelled to enter into contracts resulting from that procedure. At this juncture, there are no executed contracts. However, in order to avoid parties spending further time and resources in pursuing contracts that would be unlawful under PURPA, we believe it would be appropriate for the California Commission to stay its requirements directing Edison and San Diego to purchase pending the outcome of further administrative procedures in accordance with PURPA. We also encourage the utilities and QFs to reach a settlement that would be consistent with PURPA." (February 23 FERC Order at 26-27.)

The February 23 FERC Order precipitated the filing of various motions to stay the Update. On March 7, 1995, the Assigned Commissioner issued an interim stay of the Update solicitation and called for comments on four alternative actions that the Commission might take. On March 16, 1995, the full Commission, on its own motion, extended the interim stay in D.95-03-019, 59 CPUC2d 52. We issued this interim stay "in order to permit additional time to assess the impact of the FERC order on the Update proceeding and to review the Commission's legal and policy options. A stay will also suspend the deadlines

[4] PURPA is the Public Utility Regulatory Policies Act of 1978. The utilities filed their petition for enforcement pursuant to Section 210 of PURPA, 16 U.S.C. § 824a-3(h)(1988).

for signing of contracts by the utilities and will avoid what may be the needless expenditure of time and resources by the parties and the Commission in order to resolve the rehearing issues in this proceeding." (59 CPUC2d at 53.)

The Commission and numerous parties filed requests for rehearing or clarification of the February 23 FERC Order. FERC issued a notice stating its intent to treat these requests for rehearing as motions for reconsideration. FERC issued its *Order on Requests for Reconsideration* on June 2, 1995, upholding the February 23 FERC Order.

On July 5, 1995, the Assigned Commissioner issued a ruling (July ACR) that memorialized the public discussion among Commissioners at the June 21, 1995, meeting and stated that the Commission was unanimous in finding ratepayer interests were advanced and protected by the settlements. (July ACR at 7.[5]) The July ACR set forth criteria by which the Commission would evaluate settlements with bidders, and directed each utility to file a single application containing all the settlement agreements it wished the Commission to approve. (*Id.* at 11.)

III. This Application

On December 27, 1999, PG&E filed this application seeking approval of a settlement package containing settlements it has reached with three bidders that

[5] According to the ACR, in an exercise of authority conferred by Article 12, Section 2 of the California Constitution, the Commission voted unanimously at the June 21, 1995 meeting to delegate to the Assigned Commissioner the task of memorializing the public discussion so that it might provide guidance to the settling parties. (July ACR at 1-2.) First enacted in 1879, that portion of the Constitution provides that: " . . . Any commissioner as designated by the commission may hold a hearing or investigation or issue an order subject to commission approval."

PG&E designated as "winning bidders," subject to the outcome of certain judicial and regulatory proceedings challenging the legality of the Update. The three settlements are between PG&E and AES, SeaWest Energy Corporation and Toyo Wind Power Corporation (SeaWest/Toyo), and Zond Systems, Inc. (Zond).[6] The aggregate principal amount of the settlements is $9,525,000.[7]

The three settlements are conditioned on this Commission's approval of them.[8] If approved, the settlements will resolve all remaining issues in PG&E's Update without further litigation before this Commission, other administrative agencies, or the courts.

On March 27, the Assigned Commissioner and ALJ held a prehearing conference. Aglet Consumer Alliance (Aglet) is the only party who continues to protest this application. On May 23, 2000, the Assigned Commissioner and ALJ issued a scoping memo which indicated that Resolution ALJ 176-3030 preliminarily stated that hearings were necessary. However, at the prehearing conference, an initial schedule was set to process this matter without hearings. Under this schedule, parties had until June 14 to request hearings. No party

---

[6] PG&E's initial application did not include a settlement with Zond. On July 12, 1998, Zond changed its name to Enron Wind Systems, Inc. On March 6, 2000, Enron Wind and PG&E agreed to settle the Zond/Enron Wind claim on the basis set forth in this decision. On April 12, 2000, PG&E filed an amendment to the application which included the Zond settlement.

[7] Kenetech Windpower, Inc. (Kenetech) was also a claimant in PG&E's Update auction, but PG&E's resolution of Kenetech's claim did not involve the payment of money by PG&E to Kenetech.

[8] The PG&E/AES settlement will terminate automatically if the Commission does not approve the settlement by December 31, 2000, or if PG&E or AES do not find acceptable any condition that the Commission might attach to approval.

requested hearings. Because this application can be resolved on the parties' briefs, we determine that hearings are not necessary, and our order today makes that change to the preliminary determination in Resolution ALJ 176-3030.

The following parties filed opening or reply briefs: PG&E, AES, and Aglet. By letter dated June 14, Zond stated that it supported PG&E's opening brief and did not file a reply because no party opposed the PG&E/Zond settlement.

IV. Parties' Positions

A. PG&E and the Settling Parties

PG&E and the settling parties believe that the package of settlements is reasonable, consistent with the law, and in the public interest, and therefore should be approved. PG&E believes the settlements should be approved because they are based on the claimants' reasonable bid preparation costs or reliance costs, one of the settlement structures set forth in the July ACR, and the basis upon which the Commission approved settlements that SDG&E reached with certain of its Update claimants in D.98-12-074. PG&E also argues that the settlements are reasonable because they meet the goal articulated in the July ACR of eliminating further litigation concerning the Update between PG&E and the settling bidders.

Because the AES settlement is the only one protested, PG&E and AES go into more detail on the reasonableness of this settlement. PG&E describes certain events that occurred during the course of AES' efforts to develop its Hunters Point project and identifies the costs AES incurred at that time. PG&E also offers several scenarios under which one might argue that AES' reliance interest expenditures incurred after certain events should be discounted or excluded because such costs were not reasonably incurred. The settling parties believe that the AES settlement, which is less than one third of AES' current

claim, and which took years of settlement discussion, interspersed with litigation, and a Commission-sponsored mediation effort to achieve, is reasonable under various scenarios presented in the application.

B. Aglet

Aglet opposes PG&E's settlement with AES, unless the Commission disallows or excludes from rates about 30% of the PG&E/AES settlement amount. Aglet reaches its recommendation by excluding some of AES' claimed reliance costs because Aglet believes they are not reasonable. Aglet then further discounts AES' costs incurred from January 1994 through June 1996, based on a probability analysis of the viability of the project at each of these stages. Aglet believes that the costs should be adjusted to reflect the risk that the project would never have been completed.

Aglet recommends that if the Commission adopts its position, that it either give PG&E and AES an opportunity to revise the settlement so that ratepayers do not pay for amounts in excess of Aglet's estimates, or give PG&E an opportunity to accept that shareholders should bear the AES settlement costs in excess of Aglet's estimate. Aglet does not favor rejecting the settlement without giving the settling parties an opportunity to remove Aglet's recommended disallowance from rates. Aglet takes no position on the other settlements contained in the application.

V. Request for Supplemental Briefing

On September 15, 2000, the ALJ requested further briefing on the issue of why the Commission should approve as reasonable the PG&E/QF settlements presented in this application in light of California's current need for capacity. Subsumed in this issue is the question of whether or not the ALJ should recommend to the Commission that it reject the settlements without prejudice to

the settling parties negotiating an outcome that can provide additional power to address California's current needs.[9]

PG&E, AES, Aglet, Kenetech, the Office of Ratepayer Advocates (ORA), and Zond filed briefs in response to the ALJ ruling. (ORA remains neutral on the application.) The parties were uniform in their conclusion that the Commission should not abandon consideration of the current settlements, and should not require PG&E and the other settling parties to renegotiate their Update settlements as set forth in the ALJ ruling.[10] The parties were in general agreement that requiring PG&E and the settling bidders to renegotiate the settlements will not remedy the current supply shortage. This issue is discussed in more detail below.

VI. Reasonableness of the Settlements

A. Standard of Review

This application presents a settlement package opposed by Aglet. (Specifically, Aglet opposes the AES settlement and takes no position on the other settlements.) Therefore, we review the package of settlements pursuant to Rule 51.1(e) of the Commission's Rules of Practice and Procedure which provides that, prior to approval, the Commission must find a settlement "reasonable in

---

[9] In her ruling, the ALJ explained that currently new generation is needed to serve California. The July ACR did not limit the settlement options to buyouts, nor is this the only option contemplated by the statutes providing for restructuring of the electric industry enacted after the ACR issued. For instance, Cal. Pub. Util. Code § 367 (a)(3) provides that utilities may collect costs associated with *contracts* approved by the Commission to settle issues associated with the Update under certain conditions.

[10] Aglet continues to advocate that the AES settlement should only be approved if the Commission disallows or excludes from rates a portion of the settlement.

light of the whole record, consistent with the law, and in the public interest." As we discuss below, we find that this settlement package meets this criteria, and therefore approve it.

B. The July ACR

The July ACR memorialized the goals and objectives of the settlement process which the Commission unanimously encouraged at its June 21, 1995 meeting.

> "First, each settlement should eliminate litigation – in any agency or court – flowing from the auction. Additionally, the settlements each utility reaches with individual bidders, should, when considered as a package, (1) achieve the resource procurement statutory mandates, including mandates for diversity provided by renewable resources; (2) add capacity which lowers the operating cost of the system; (3) add capacity which meets the reliability needs, if such a need has been identified." (July ACR at 7-8.)

The July ACR also memorialized a number of settlement options (without intending to make an exclusive list), such as "the option," "the buyout," and "the contract." (*Id.* at 8.) The July ACR recognized that FERC also encouraged the utilities and the QFs to achieve settlements consistent with PURPA. However, it cautioned that the Commission did not encourage settlements at all costs:

> "The surest way to achieve settlement would be to assure parties that any costs of settlement would be fully recovered from ratepayers so that QFs merely needed to tell utilities how large a check to write. We are decidedly not encouraging such settlement, nor are we preapproving recovery of settlement costs. Commissioner Conlon said it best during our public discussion: we want to see value received for payment given." (*Id.* at 9.)

In the July ACR, we defined (1) "the option" as a settlement which forms a contract that provides the utility an option to have additional capacity built at a future time; (2) "the buyout" as a settlement which makes an otherwise winning bidder whole for reasonable bid preparation or reliance costs; and (3) "the contract" as an agreement between a winning bidder and the utility to sign an FSO4 or a modified FSO4. (*Id.* at 8.) The Assigned Commissioner elaborated that he would view with disfavor buyout contracts which pay QFs more than their bid preparation or reliance interest, stating: "This means that I will not look with favor on buyout agreements which seek to go beyond the recoupment of a reliance interest to approximate an expectation interest. The reason is plain: in a buyout strategy ratepayers will not gain the advantage of capacity additions." (*Id.*) In assessing the reasonableness of the settlement package, we are guided by the July ACR, as discussed further below.

C. Reasonable Bid Preparation Costs or Reliance Costs

The July ACR memorialized the goals and objectives of the settlement process and a number of settlement options which the Commission unanimously encouraged at its July 21, 1995 meeting. Thus, it carries more weight than an individual ACR expressing the views of only one member of the Commission. (See e.g., D.98-12-074 at 16.)

In D.98-12-074, we approved three of SDG&E's Update settlements as reasonable and in the public interest on the basis that SDG&E followed the direction of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs. (D.98-12-074 at 17.) We further stated that in our assessment of litigation risk,

the bidders SDG&E designated as "winning bidders" were not somehow legally entitled to receive their reliance interest.

> "Footnote 4 of the ACR elaborated on the full Commission's definition of a 'buyout,' and we reaffirm this footnote today, for our review of settlement packages such as this, in which all settlements were executed after the February 23 FERC Order and the July ACR. This does not mean that, in our assessment of litigation risk, we believe that all bidders designated by SDG&E as 'winning bidders' are somehow legally entitled to receive their reliance interest. Rather, we view such payment as equitable, in light of the time and resources these particular bidders have committed to the lengthy and contentious Update proceeding, which has not yet terminated, as well as their cooperation in engaging in this settlement process as directed by the July ACR." (*Id.* at 16-17.)[11]

In this application, PG&E has reached a settlement with all three bidders based on the bidders' reasonable bid preparation or reliance costs. PG&E did not, in all instances, determine and then settle for the bidders' bid preparation or reliance costs. Rather, PG&E determined what costs were reasonable by, for example, removing AES' claimed interest charges from its claimed costs. PG&E then reached individual settlements where the bidders' reasonable bid preparation or reliance costs served as a cap for the negotiated settlements. Because PG&E followed the directives of the July ACR and

[11] Although Commission approval of a settlement is only binding in the proceeding in which the settlement is proposed (see Rule 51.8 of the Commission's Rules of Practice and Procedure), the rationale in D.98-12-074, approving certain settlements SDG&E reached with its designated "winning bidders" in its Update, is useful to review in this case where the settlements are also for bidders that PG&E has designated as "winning bidders" in its Update, and the settlements were all reached after the July ACR issued.

achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs, we find the settlements reasonable and in the public interest, as well as consistent with prior Commission decisions approving a similar settlement.

As in SDG&E's case, our approval does not mean that we believe that all of the bidders designated by PG&E as winning bidders are somehow legally entitled to receive their reliance interest. Rather, we view such payment as equitable in light of the time and resources these particular bidders have committed to the lengthy and contentious Update proceeding, which has not yet terminated, as well as their cooperation in engaging in this settlement process as directed by the July ACR. (See D.98-12-074 at 16-17.)

D. The PG&E/AES Settlement

The PG&E/AES settlement does not pay AES all of its claimed bid preparation or reliance costs, but is framed within the parameters of what the parties believe to be AES' reasonable bid preparation or reliance costs. Prior to filing its application, PG&E engaged a certified public accountant (CPA) to review AES' cost data. The CPA found a few booking mischaracterizations and, after making adjustments to reflect a change from a cash to an accrual basis, and removing AES' claimed interest costs, confirmed that the costs AES claims were incurred on the Hunters Point Project. PG&E generally based its settlement on AES' recorded costs through September 1995, and discounted costs from October 1995 through March 1996.

The principal dispute between AES and PG&E in reaching this settlement concerned whether AES' continued expenditures after certain significant events during the project development were reasonable. This is the same principal issue that concerns Aglet. The fact that AES incurred the costs

described in the application and when those costs were incurred are both undisputed.

Aglet believes AES' costs should be discounted as presented in its brief, and that its adjusted costs should serve as a cap for any PG&E/AES settlement. Aglet begins by using AES' costs, as adjusted by PG&E's expert CPA witness. Then, as did PG&E, Aglet also removes interest charges from AES' costs. Aglet recommends further adjustments which we discuss below.

1. Costs incurred before PG&E declared AES a "winning bidder" in the Hunters Point auction

Aglet believes that the costs AES incurred before PG&E declared AES a winning bidder in the Hunters Point auction should be removed because such costs were sunk. Aglet in large part bases its argument on the July ACR which referred to bid preparation costs or reliance costs, and argues that they are two mutually exclusive categories.

We disagree. Neither the July ACR nor D.98-12-074 define exactly what reliance costs include. However, as discussed earlier, the July ACR draws a distinction between a contracting party's reliance interest and expectation interest. (See also July ACR at 9, footnote 4.)

General legal principles in remedies provide that a contracting party's expectation interest refers to the expectation that the contract will be performed. A reliance recovery is based on what a contracting party spent in reasonably relying on the contract, even though what he spent did not benefit the defendant. This includes costs where a party to a contract, relying on the performance of the other party's promise, has spent money preparing to perform a contract. (See generally Dobbs, Remedies (1973) § 12.1 at 786-788.) Although both general principles cited above refer to the existence of a contract, the July

ACR did not limit reliance interest recovery to cases involving contracts because the Commission did not rule whether any claimant had an enforceable contract. (In fact, as stated above, the Commission made clear in D.98-12-074 at 16, that we did not, in assessing litigation risk, believe that all of the bidders designated by SDG&E's as "winning bidders" were somehow legally entitled to receive their reliance interest.) Therefore, the reliance interest costs we refer to here include reasonable costs a bidder incurred in preparing to perform an anticipated contract.

A bidder would incur bid preparation costs as part of its preparation efforts to perform an anticipated contract. Therefore, bid preparation costs are a category of reliance interests, and we approve their inclusion as part of AES' reliance costs on which a settlement can be based.

2. NOx Offsets

Aglet believes the NOx offset costs should not be included as reliance costs because the offsets have market value. Aglet recommends removing only the original offset costs, and not their market value, under the theory that offset profits have the character of expectation costs. We agree with Aglet that such costs should be removed. However, as PG&E points out, the settlement is still reasonable because even if the value of NOx offset costs is deducted from AES' costs, AES' reasonable reliance costs still exceed the settlement.

3. Letter of Credit Fees

Aglet does not believe it reasonable to include letter of credit fees in AES' costs because such fees are similar to interest charges. However, the letter of credit was one of the prerequisites for executing an FSO4 contract. (See 55

CPUC2d 292, 294 and 296.) Therefore, the letter of credit fees are a reasonable reliance cost upon which to base a settlement.

4. Discounting of AES' costs

Aglet also argues that AES' costs between 1994 and 1996 should be further discounted for the risks in existence at that time, in order to determine whether the settled amount is reasonable in relation to the risk that each party would obtain its desired result through litigation. Aglet believes that such discounting is a reasonable method for testing the settled amount because there was a risk that the AES project would not be completed. Aglet recognizes that PG&E has already discounted or scaled back AES' costs before reaching this settlement, but believes that its own discounting is superior to that of PG&E's.

Aglet argues that the Commission should take into account the project's viability over time, referencing the Commission's final guidelines for contract revisions which state that where a project would not be viable, then contract modifications should not be accepted, and if there is a genuine question of viability, then negotiated modifications may result in a reasonable settlement. Aglet recognizes that AES did not have a signed contract with PG&E, and that the final guidelines do not strictly apply, but maintains that the principle that ratepayers should not support projects that are not viable is valid. In other words, Aglet is arguing is that AES' project costs should be discounted at certain points in time to reflect the risks of hurdles not overcome, and to reflect the likelihood that the project would not ever have become used and useful.

PG&E and AES believe that if Aglet's recommended discount method is defensible at all, it would only be so in the context of applying a discount to AES' expectation interest of expected profits. PG&E argues that by applying the performance risk discount to an amount that does not include an

expectation component, Aglet would assign to AES all of the downside associated with performance risk with no potential for any upside recovery.

In reviewing Aglet's arguments, we must determine whether it was reasonable for AES to make particular reliance expenditures at given points in time based on facts that AES knew or should have known at the time the costs were incurred. Our findings with respect to AES do not mean that the settlement should be for the full amount of AES' reasonable bid preparation or reliance costs, but that these costs can serve as a ceiling for a settlement. Furthermore, our findings are unique to AES and should not serve as precedent for any other bidder in any utility's Update solicitation, because of the unique facts surrounding the Hunters Point solicitation which are more fully discussed below. Thus, our assessment of the reasonableness of AES' reliance costs at a given point in time should not be used by any other utility or bidder as precedent, because no other bidder was similarly situated to AES.

a) January 10, 1994, when PG&E announced AES as a winning bidder

Aglet believes AES' costs should be discounted beginning in January 1994 when PG&E announced the winning bidders. Aglet believes that this discount reflects the general risk of AES going forward without a contract with PG&E and the risk that some costs were not prudently incurred.[12]

In January 1994, the Commission issued D.94-01-020 in response to a request from PG&E for guidance about the Update auction regarding the

[12] Aglet states that unreasonable costs would harm AES investors if the project was completed, or they might eventually be disallowed in a proceeding like this one if the project was not completed.

acceptability of a certain wind bid. The Commission directed that PG&E should not announce the FSO4 auction winners for its wind project until further order from the Commission, but in all other respects, PG&E's auction should remain on schedule. Specifically, the Commission directed PG&E to announce the FSO4 auction winners for the Hunters Point project as scheduled. (D.94-01-020, 53 CPUCed at 36.) Several days later, PG&E announced AES as the winning bidder for the Hunters Point solicitation. Because the Commission had just directed PG&E to announce the FSO4 auction winners for the Hunters Point project, it is reasonable for AES to have incurred reliance expenditures at this date and these expenditures need not be further discounted as the basis for a settlement.

b) April 20, 1994, when the Commission commenced electric industry restructuring efforts

Aglet argues that AES' costs should be discounted by 30% beginning May 1994, the month after the Commission issued the Blue Book which began what is now known as electric industry restructuring.[13] Aglet argues that the Commission committed to policies that include market-based regulation, direct access and replacing the Update process with competition, and therefore project completion risks for QFs rose markedly.

On April 27, 1994, shortly after the Blue Book issued, PG&E filed a motion requesting that the Commission immediately suspend the Hunters Point solicitation while the Commission considered the remaining Update schedule in light of the Commission's electric industry restructuring efforts. In

[13] This proceeding is Rulemaking 94-04-031/Investigation 94-04-032.

D.94-06-050, 55 CPUC2d 291, the Commission directed that the Hunters Point solicitation should continue.

> "To date, we have not suspended the Hunters Point solicitation, and we will not do so now given the unique procedural posture of this portion of PG&E's solicitation.
>
> "We also see a ratepayer benefit in allowing this portion of the solicitation to go forward." (55 CPUC2d at 296.)

The Commission did not modify D.94-06-050 as applied to Hunters Point in D.94-12-051, 58 CPUC2d 300, 305-306. A bidder in AES' position could reasonably interpret these decisions as encouragement to proceed in the Update process. Therefore, it is reasonable for AES to have continued to incur reliance expenditures at this date and these expenditures need not be further discounted as the basis for the settlement.

c) February 23, 1995, when FERC concluded that the Update auction violated federal law

Aglet argues that AES' costs should be discounted by 60% beginning March 1995 which is the month after FERC found that the Commission's solicitation program violated federal law, and when the Commission issued an order staying the solicitation. Aglet states that the combination of FERC's determination and the Commission's commitment to competition for generation made it unlikely that the Commission would try to restructure its past solicitation to lock the utilities into long term contracts.

PG&E and AES argue that Aglet overlooks that FERC's order was subject to reconsideration, and also that the order expressly stated that FERC did not believe it to be in the public interest to invalidate preexisting contracts, and that AES believed that it had an existing FSO4 contract. They also point out that

FERC encouraged the utilities and certain bidders to reach a settlement consistent with PURPA.

In March 1995, AES believed it had an FSO4 contract, while PG&E argued that AES did not. (AES requested that the Commission find it had a contract in May 1994, but the Commission found it was unnecessary to reach that issue because it had the discretion to permit the parties to complete the contracting process. (See 55 CPUC2d at 296.)) In its order staying the solicitation, the Commission in March 1995 again did not reach the issue of whether there were any preexisting contracts between the utilities and the QFs in the FSO4 solicitation. Furthermore, in March 1995, parties to the Update were briefing various options including whether to continue the existing Update process by shifting reliance from an attempted implementation of federal law to intrinsic state authority. Given all of these events and the prior Commission decisions particular to AES, it is reasonable for AES to have continued to incur reliance expenditures at this date and these expenditures need not be further discounted as the basis for the settlement.

d) June 1995, when FERC denied reconsideration

Aglet believes costs should be discounted by 70% in June 1995 to reflect FERC's denial of appeals by AES and other parties because the likelihood that AES would ever produce power under contract with PG&E was reduced materially.

PG&E and AES argue that this argument fails to consider the facts discussed above (that the FERC order did not apply to existing contracts, AES' belief that it had a contract, and that the Commission was still considering various options for resolving the Update). At this time, AES had already

incurred most of the reliance costs which serve as the basis for the settlement. We agree that at the time these events occurred, it was reasonable for AES to have continued to incur reliance expenditures at this date and these expenditures need not be further discounted as the basis for the settlement.

e) July 5, 1995, when the July ACR issued

Aglet also argues that AES' costs should be discounted beginning in July 1995 when the July ACR issued, because the ACR encouraged settlement of disputes such as the one between PG&E and AES. Aglet states that there was only a remote chance that the project would go forward at this point, and that AES should have sharply curtailed its spending.

PG&E and AES argue that under the July ACR, two of the settlement options expressly contemplated power purchase contracts. At this time, AES had already incurred the bulk of the reliance costs which serve as the basis for the settlement. Because a reasonable bidder in AES' situation, given prior Commission decisions particular to AES, may likely have continued its development efforts at this point (at least for several more months) with the expectation that it could either convince the Commission or PG&E that it had an FSO4, or PG&E to negotiate a power purchase agreement as a settlement option, it was reasonable for AES to have continued to incur reliance expenditures at this date and these expenditures need not be further discounted.[14]

[14] Moreover, in April 1996, AES received approval to site the project at Hunters Point from the California Energy Commission. However, this approval was conditioned upon AES obtaining all necessary approvals from the City and County of San Francisco.

f) June 19, 1996, when the San Francisco Board of Supervisors urged the mayor and all city agencies to refrain from action that would result in development of the AES project

Finally, Aglet believes that all costs should be discounted in July 1996, the month after the San Francisco Board of Supervisors apparently stymied further development of the AES project. Aglet states that the combination of Commission policy on generation competition, FERC disapproval of the solicitation process and strong local opposition made continuation of the AES project pointless.

AES argues that even these expenditures might be deemed reasonable, because the Board's action was non-binding and subject to change, and could attempt to reverse the San Francisco Board of Supervisors' resolution. We agree with Aglet that AES' actual reliance expenditures at this point should have been heavily discounted. However, the settlement amount is less than AES' reasonable reliance expenditures as of June 1996. (In fact, PG&E began discounting AES' reliance costs on which the settlement is based shortly after the July 1995 ACR issued.) Thus, the settlement amount falls within the bounds of AES' reasonable bid preparation or reliance costs.

VII. The Effect of California's Current Capacity Need on this Proceeding

As stated above, in September 2000, the ALJ requested further briefing on the issue of whether or not she should recommend to the Commission that it reject the settlements without prejudice to the settling parties negotiating an outcome that can provide additional power to address California's current needs. The parties were uniform in their conclusions that the Commission should not

abandon consideration of the current settlements, and should not require PG&E and the other settling parties to renegotiate their settlements.

The parties are in general agreement that requiring PG&E and the settling bidders to renegotiate the settlements will not remedy the current supply shortage. According to ORA, the reasonableness of the Update settlements is probably best considered separately from the much broader issue of capacity need and responsibility for resource procurement. Aglet states that there is no evidence in this proceeding that the three bidders could complete their projects in time to cure today's market problems, or that prices for electricity generated by the projects would help drive current market prices back toward costs of production. Also, many parties point out that because FERC declared that the Commission's implementation of the FSO4 violated PURPA, contract negotiations between the parties may have to commence from scratch, and would necessarily be lengthy and would create uncertainty.[15] According to some parties, the risk of future litigation, eliminated by the proposed settlement, would not be eliminated if the Commission rejected the current settlements and directed further negotiation.

PG&E also believes that it could obtain a better result for ratepayers by negotiating agreements to meet California's energy needs in accordance with the Commission's recent decision regarding bilateral contracts, rather than under the auspices of an Update settlement, because the bidders in the Update process, if

[15] PG&E points out that settlement negotiations with each of the settling parties to reach the current agreements took approximately a year, and that negotiations concerning the terms and conditions of a mutually acceptable power purchase agreement could be even more complex and time consuming.

acting as rational actors in the marketplace, would seek to recover their sunk costs.

However, ORA requests the Commission to find in this docket that PG&E should not receive rate recovery of its summer wholesale power procurement costs associated with 244 megawatts (the megawatts associated with the Update bids underlying the solicitation) it could have obtained if it had entered into these FSO4 contracts, or a negotiated contract settlement. ORA also argues that in the event PG&E chooses to negotiate for capacity in the future with the settling bidders in this application, PG&E should do so knowing that the maximum the Commission will find reasonable is the contract cost, less the approved settlement amount. PG&E strongly opposes both of ORA's contentions.

Even if we were to require the settling parties to renegotiate an outcome that can provide additional power for California, there is no evidence in this proceeding (as Aglet points out) that the three bidders could complete their projects in time to cure today's market problems, or that prices for electricity generated by the projects would help drive current market prices back toward costs of production. Therefore, we approve the settlements as presented in the application, and do not direct further negotiations. However, we need not and do not make a finding that PG&E did not know or should not have known about the current energy crisis at the time it entered into the settlements. Rather, we hold this package of settlements to be reasonable, in part, because there is no evidence that reactivating the Update solicitation at this point will contribute to a solution to the current energy crisis.

We do not address the additional issues raised by ORA in this proceeding, but permit ORA to raise them in the proceeding where we review PG&E's rate

recovery of its summer wholesale power procurement costs, or other appropriate proceeding.

Because PG&E followed the directives of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs, we find the settlement package as a whole to be reasonable, consistent with the law, and in the public interest and that PG&E's entering into these settlement agreements is prudent. In addition, we (1) authorize full recovery, through PG&E's Transition Cost Balancing Account (TCBA), of payments made by PG&E under these settlement agreements subject to PG&E's prudent administration of the settlement agreements; and (2) find these agreements replace all effective megawatts in PG&E's Update solicitation, and that these agreements shall be in lieu of the Update capacity that would otherwise have been awarded to bidders pursuant to PG&E's Update solicitation. In light of this determination, the limited rehearing ordered in D.94-12-051 should be cancelled with respect to PG&E and all effective megawatts in PG&E's Update solicitation.

Comments to the Draft Decision

The draft decision of ALJ Econome in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7. Aglet filed comments to the draft decision and PG&E and Zond filed reply comments. We affirm the draft decision but make changes to improve the discussion and correct typographical errors.

Findings of Fact

1. In this application, PG&E requests approval of a settlement package it has reached with three bidders in PG&E's Update auction. The aggregate principal amount of the settlement package is $9,525,000.

2. According to PG&E, each of these three settlements is based on the settling bidders' reasonable bid preparation costs or reliance costs, one of the settlement structures suggested in the July ACR.

3. The July ACR memorialized the goals and objectives of the settlement process and a number of settlement options, which the Commission unanimously encouraged at its June 21, 1995 meeting. Thus, it carries more weight than an individual ACR expressing the views of only one member of the Commission.

4. The July ACR defined the settlement outcome of a "buyout" as "a settlement which makes an otherwise winning bidder whole for reasonable bid preparation costs or reliance costs."

5. In D.98-12-074, we approved three of SDG&E's Update settlements as reasonable and in the public interest on the basis that SDG&E followed the direction of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs.

6. PG&E followed the direction of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs.

7. A bidder would incur bid preparation costs as part of its preparation efforts to perform an anticipated contract. Therefore, bid preparation costs are a category of reliance interests as used in the July ACR.

8. Even if the value of the NOx offset costs is deducted from AES' reasonable costs, AES' reliance costs still exceed the settlement amount.

9. The letter of credit was one of the prerequisites for executing an FSO4 contract.

10. In D.94-01-020, the Commission directed PG&E to announce the FSO4 auction winners for the Hunters Point project as scheduled. Several days later, PG&E announced AES as the winning bidder for the Hunters Point solicitation.

11. In D.94-06-050, 55 CPUC2d 291, the Commission directed that the Hunters Point solicitation should continue. The Commission refused to modify D.94-06-050 as applied to Hunters Point in D.94-12-051, 58 CPUC2d 300.

12. In March 1995, AES believed it had an FSO4 contract, while PG&E argued that AES did not. In its order staying the solicitation, the Commission in March 1995 again did not reach the issue of whether there were any preexisting contracts between the utilities and the QFs in the FSO4 solicitation. In March 1995, parties to the Update were briefing various options including continuing the existing Update process by shifting reliance from an attempted implementation of federal law to intrinsic state authority.

13. As of the time the July ACR issued, AES had already incurred the bulk of the reliance costs which serve as the basis for the settlement.

14. AES' actual reliance expenditures in June 1996 should have been heavily discounted, but the settlement amount is less then AES' reasonable reliance expenditures as of June 1996.

15. In response to a recent ALJ ruling requesting further briefing on the issue of whether or not the ALJ should recommend to the Commission that it reject the settlements without prejudice to the settling parties negotiating an outcome that can provide additional power to address California's current needs, the parties were uniform in their conclusions that the Commission should not abandon consideration of the current settlements, and should not require PG&E and the settling parties to renegotiate the settlements.

16. Even if we were to require the settling parties to renegotiate an outcome that can provide additional power to California, there is no evidence in this proceeding that the three settling bidders could complete their projects in time to cure today's market problems, or that prices for electricity generated by the projects would help drive current market prices back toward costs of production.

17. We need not and do not make a finding that PG&E did not know or should not have known about the current energy crisis at the time it entered into the settlements. Rather, we hold this package of settlements to be reasonable, in part, because there is no evidence that reactivating the Update solicitation at this point will contribute to a solution to the current energy crisis.

18. We do not raise the additional issues raised by ORA in this proceeding, but permit ORA to raise them in the proceeding where we review PG&E's rate recovery of its summer wholesale power procurement costs, or other appropriate proceeding.

Conclusions of Law

1. Because this application can be resolved on the parties' briefs, hearings are not necessary, and this order should change the determination preliminarily made in Resolution ALJ 176–3030.

2. We review the package of settlements pursuant to Rule 51.1(e) of the Commission's Rules of Practice and Procedure which provides that, prior to approval, the Commission must find a settlement "reasonable in light of the whole record, consistent with the law, and in the public interest."

3. Reliance costs as used in the July ACR include reasonable costs a bidder incurred in preparing to perform an anticipated contract.

4. In assessing the reasonableness of the settlement package, we are guided by the July ACR.

5. Because PG&E followed the directives of the July ACR and achieved settlements with the three settling bidders for amounts based on reasonable bid preparation or reliance costs, we find the settlements to be reasonable and in the public interest, as well as consistent with prior Commission decisions approving a similar settlement.

6. We determine whether it was reasonable for AES to make particular reliance expenditures at given points in time based on facts that AES knew or should have known at the time the costs were incurred.

7. Our findings with respect to AES do not mean that the settlement should be for the full amount of AES' reasonable bid preparation or reliance costs, but that these costs can serve as a ceiling for a settlement.

8. Our findings with respect to AES are unique to AES and should not serve as precedent for any other bidder in any utility's Update solicitation, because of the unique facts surrounding the Hunters Point solicitation. Thus, our assessment of the reasonableness of AES' reliance costs at a given point in time should not be used by any other utility or bidder as precedent, because no other bidder was similarly situated to AES.

9. The PG&E/AES settlement falls within the bounds of AES' reasonable bid preparation or reliance costs.

10. With respect to the three settlements PG&E has reached with AES, SeaWest/Toyo and Zond, and which are contained in PG&E's application, we: (1) find the settlement package as a whole to be reasonable, consistent with the law, and in the public interest and that PG&E's entering into these settlement agreements is prudent; (2) authorize full recovery, through PG&E's TCBA, of payments made by PG&E under these settlement agreements subject to PG&E's prudent administration of the settlement agreements; and (3) find these

agreements replace all effective megawatts in PG&E's Update solicitation, and that these agreements shall be in lieu of the Update capacity that would otherwise have been awarded to bidders pursuant to PG&E's Update solicitation.

11. In light of the determinations made in the preceding Conclusion of Law paragraph, the limited rehearing ordered in D.94-12-051 should be cancelled with respect to PG&E and all effective megawatts in PG&E's Update solicitation.

12. Because we wish to resolve issues relating to PG&E's Update solicitation expeditiously, this decision should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The application of Pacific Gas and Electric Company (PG&E) for approval of its Biennial Resource Plan Update (Update) settlement package is reasonable, consistent with the law, and in the public interest, and is approved.

2. The Commission: (1) finds the settlement package as a whole to be reasonable, consistent with the law, and in the public interest and that PG&E's entering into these settlement agreements is prudent; (2) authorizes full recovery, through PG&E's Transition Cost Balancing Account, of payments made by PG&E under these settlement agreements subject to PG&E's prudent administration of the settlement agreements; and (3) find these agreements replace all effective megawatts in PG&E's Update solicitation, and that these agreements shall be in lieu of the Update capacity that would otherwise have been awarded to bidders pursuant to PG&E's Update solicitation.

3. In light of the determinations made in the preceding Ordering Paragraph, the limited rehearing ordered in Decision 94-12-051 is cancelled with respect to PG&E and all effective megawatts in PG&E's Update solicitation.

4. Because this application can be resolved on the parties' briefs, hearings are not necessary, and this order shall change the determination preliminarily made in Resolution ALJ-176.

5. This proceeding is closed.

This order is effective today.

Dated December 21, 2000, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
CARL W. WOOD
Commissioners