Decision No. C03-0988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 02A-665E

IN THE MATTER OF THE APPLICATION OF PUBLIC SERVICE COMPANY OF COLORADO FOR APPROVALS IN CONNECTION WITH THE THIRD AMENDMENT TO THE ON-SYSTEM POWER PURCHASE AGREEMENT BETWEEN THERMO POWER AND ELECTRIC, INC. AND PUBLIC SERVICE COMPANY OF COLORADO.

DECISION GRANTING EXCEPTIONS

Mailed Date: August 28, 2003
Adopted Date: August 13, 2003

I. BY THE COMMISSION

A. Statement

1. This matter comes before the Commission for consideration of Exceptions to Decision No. R03-0687 (Recommended Decision) filed by Thermo Power and Electric, Inc. (Thermo), and Public Service Company of Colorado (Public Service or Company). In that decision, the Administrative Law Judge (ALJ) recommended denial of Public Service's Application for Approval of the Third Amendment to the On-System Power Purchase Agreement between Thermo and Public Service. Public Service and Thermo, pursuant to the provisions of § 40-6-109(2), C.R.S., except to the Recommended Decision. The Trustees of the University of Northern Colorado (UNC), and the Colorado Independent Energy Association and Electric Power Supply Association filed briefs as *amicus curiae* in support of the Exceptions.[1] Commission Staff (Staff) filed its Response to Exceptions and *Amicus Curiae* Briefs. Lastly,

[1] By prior order, we granted permission for the filing of briefs as *amicus curiae*.

Thermo filed its Reply to Staff's Response to Exceptions.[2] Now being duly advised, we grant the Exceptions and approve the Company's Application.

B. Statement of the Case

2. This case involves a power purchase agreement between Thermo and Public Service pursuant to the provisions of the Public Utility Regulatory Policies Act (PURPA).[3] Specifically, in 1985 Public Service and Thermo[4] entered into a power purchase agreement in which Thermo agreed to sell to the Company electric capacity and energy from Thermo's 70-megawatt cogeneration facility located at UNC. That agreement was for a 15-year term from the date of commercial operation of Thermo's facility, that is, until August 28, 2003. However, one of the provisions of the 1985 agreement, Article XIV(B), provided for the possibility of an extension of the agreement. Article XIV(B) states:

> **…**In the last three (3) months of the thirteenth (13th) year after the Date of Commercial Operation, Buyer (Public Service) shall state to Seller (Thermo) the capacity payment rate in $/KW-Month or in $/KWH for the Metered Capacity Output of the Facility that Buyer would pay for the output during a five-year and a ten-year extension of this Agreement beyond the initial fifteen-year term. Said capacity payment rate shall be computed pursuant to Article II(A) in accordance with Sheet P-17 of Attachment E, the current Company Tariff as in effect on the date and year first above written, which would take into account any hypothetical capital additions, retirement and depreciations with reference to the hypothetical plant. Buyer will pay Seller for Metered Energy Output of the Facility during a five-year or ten-year extension of this Agreement, an energy payment, per kilowatt hour, calculated in accordance with Attachment E, as in effect on the date and year first above written. Seller shall have one hundred eighty (180) days from receipt of said revised capacity payment rate to accept or reject it. If Seller Accepts the offer, Seller shall notify Buyer in writing within such period, specifying in such acceptance the period for which this Agreement shall be extended (five or ten years)....

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[2] We grant Thermo's Motion for Leave to Reply to Staff's Response.

[3] Specifically, 16 U.S.C. § 824a-3.

[4] Thermo is a "qualifying facility" under PURPA. A qualifying facility is an electric power producer not controlled by a public utility and entitled to PURPA benefits.

3. On August 27, 2001, a date within the last three months of the thirteenth year of the facility's commercial operation, Public Service sent a letter to Thermo stating capacity rates that the Company would pay for an extension of the 1985 agreement, pursuant to Article XIV(B). That letter and its enclosure explained the calculation used by Public Service to derive the proposed revised rates. The Company proposed to pay Thermo $7.45/kw-month for a ten-year extension, and $4.96/kw-month for a five-year extension. On October 18, 2001, Thermo responded to the Company's letter, stating that Public Service had made a number of errors in calculating the new rates. That letter requested that Public Service promptly and correctly recalculate new capacity payment rates for the extension period.

4. Between October 2001 and February 2002, Thermo and Public Service continued to discuss and negotiate the assumptions to be used in calculating new capacity rates. On February 8, 2002, the Company sent a letter to Thermo stating revised rates. Public Service accepted some of Thermo's proposed changes to the calculation and rejected others. As a result, the February 8, 2002 letter proposed capacity rates of $8.82/kw-month for a ten-year extension of the 1985 agreement, and $5.88/kw-month for a five-year extension. On February 19, 2002, Thermo responded to the February 8, 2002 letter, accepting the rate of $8.82/kw-month for a ten-year extension of the 1985 agreement. The February 19, 2002 letter of acceptance was within 180 days of the Company's initial letter stating new capacity rates for power from Thermo's facility (*i.e.,* the August 27, 2001 letter). The Company's and Thermo's agreement to a ten-year extension of the 1985 agreement is set forth in the Third Amendment to their power purchase agreement.

5. Public Service filed its Application requesting Commission approval of the Third Amendment on December 20, 2002. Staff intervened in this proceeding, and we referred the

matter to an ALJ for hearing. The parties prefiled testimony in accordance with the procedural schedule set by the ALJ. On April 18, 2002, Staff filed its Motion for Summary Judgment, generally arguing that the Third Amendment was a new contract rather than an extension of the 1985 agreement. Since Thermo had not bid the 70 megawatts of power from the facility in the Company's 1999 Integrated Resource Planning (IRP) process,[5] Staff argued, the Commission could not approve the proposed power purchase agreement.

6. The ALJ heard oral argument on Staff's Motion for Summary Judgment. Based on the pleadings, the oral argument, and certain prefiled testimony, the ALJ concluded that the Third Amendment is a new contract. And as a new contract the Third Amendment was subject to the IRP Rules. Because Thermo did not participate in the 1999 IRP process for Public Service, the ALJ concluded that the Commission cannot approve the new contract without a waiver of the IRP Rules. The ALJ further determined that no good cause for waiving the rules was stated here; therefore, the Application for approval of the Third Amendment should be denied. Public Service and Thermo except to the ALJ's Recommended Decision.

C. Thermo Motion to Leave to Reply to Staff's Response

7. We first address Thermo's motion to reply to Staff's Response to Exceptions. The motion states that Staff's Response raises issues not previously asserted by Staff in the summary judgment portion of the case before the ALJ. Thermo is incorrect. Our review of Staff's Motion for Summary Judgment indicates that Staff did raise the issue asserted in its Response to the

[5] The IRP process was established by Commission rules previously set forth at 4 *Code of Colorado Regulations* (CCR) 723-21. The IRP Rules have since been replaced by new Least Cost Resource Planning Rules set forth at 4 CCR 723-3. Generally, under the IRP Rules Public Service was required to purchase new capacity under a bidding process approved by the Commission. Without a waiver of the rules, Public Service was prohibited from acquiring new capacity outside of the IRP process.

Exceptions: that the Third Amendment changes the method of paying for capacity from the Thermo facility (discussion *infra*). *See* Staff Motion for Summary Judgment, pages 5-6.

8. However, we note that the ALJ, in recommending that the Application be denied, did not rely on the arguments asserted in Staff's Motion for Summary Judgment. The Exceptions by Thermo and Public Service primarily address the conclusions set forth in the Recommended Decision. We further note that Staff's Response to the Exceptions does more than simply address arguments in the Exceptions; it re-asserts the claim that the Third Amendment changes the method of making capacity payments to Thermo.[6] Because the Exceptions primarily address the Recommended Decision instead of the arguments contained in Staff's Response to Exceptions, we conclude, that without the Reply, Thermo will not have had a fair opportunity to address Staff's arguments to the Commission that the Application should be denied. Therefore, we grant the Motion for Leave to Reply to Staff's Response to Exceptions.

D. Exceptions

9. Essentially, the Recommended Decision relies upon two separate determinations--either one is sufficient to support denial--for concluding that the Third Amendment is a new power purchase contract instead of an extension of the 1985 agreement, and, as such, should be denied: (1) Thermo and Public Service failed to comply with the procedures for extending the 1985 agreement pursuant to Article XIV(B); therefore, the Third Amendment is not an extension of the original agreement, but an entirely new power purchase agreement; and (2) The Third Amendment substantially changes the 1985 agreement, and, as such, is a new power purchase

[6] Because the Commission can rule on this matter without regard to the recommendations of the ALJ (§ 40-6-109(2), C.R.S.), it is permissible for us to consider the argument asserted by Staff in the Response to the Exceptions.

agreement. Public Service and Thermo dispute both of these determinations in the Recommended Decision. For the reasons discussed below, we agree with the Exceptions.

E. Compliance with the Procedures in Article XIV(B)

10. As noted above, Public Service proposed new capacity payment rates for a contract extension on August 27, 2001. However, in its October 18, 2001 response, Thermo did not accept those proposed payments. Instead, Thermo objected to Public Service's calculation, and eventually, on February 8, 2002, Public Service offered revised rates to Thermo. The rates proposed in the February 8, 2002 letter are those ultimately accepted by Thermo and set forth in the Third Amendment.

11. The Recommended Decision points out that Article XIV(B) required Public Service to submit an offer for an extension of the contract at new rates within "the last three (3) months of the thirteenth (13^{th}) year" after the date of commercial operation of Thermo's facility, specifically by August 28, 2001. The Company's August 27, 2001 letter complied with this provision. In effect, the Recommended Decision concludes that the *only* offer for extension that Thermo could accept, within the contemplation of Article XIV(B), was an offer made within the last three months of the thirteenth year of commercial operation of the facility, in this case the offer contained in the August 27, 2001 letter. What Thermo ultimately accepted, as represented in the Third Amendment, was the offer made by Public Service in its February 8, 2002 letter. That offer was outside of the prescribed time specified in Article XIV(B), and, therefore, could not serve as the basis for an extension of the 1985 agreement.

12. The Recommended Decision also reasoned that Article XIV(B) constituted an option contract for extension of the 1985 agreement. Notably, those terms did not permit Thermo and Public Service to negotiate new capacity rates. The option in Article XIV(B)

specifically provided for Public Service to make an offer and for Thermo to accept or reject that offer. According to the Recommended Decision, the October 18, 2001 letter from Thermo constituted a rejection of the offer for extension (*i.e.,* the Company's August 27, 2001 letter). This rejection terminated the option provisions of Article XIV(B). For all these reasons, the Recommended Decision holds that the Third Amendment is a new contract, not an extension of the 1985 agreement.

13. The Exceptions dispute the Recommended Decision's determinations and we agree with many of those arguments. As Public Service and Thermo point out, Thermo's October 18, 2001 response to the Company's August 27, 2001 offer was not a rejection of that offer. Thermo did not say that it was rejecting an extension of the 1985 contract. Rather, Thermo's response disputed Public Service's calculation of the capacity payment rates for an extension. Article XIV(B) did not specify precise prices for an extension of the 1985 contract. Instead, Article XIV(B) specified the *methodology* for calculating extension prices (*i.e.,* "pursuant to Article II(A) in accordance with Sheet P-17 of Attachment E" and taking into account "hypothetical additions, retirements and depreciations with reference to the hypothetical plant"). Calculating new capacity prices for a contract extension involved a number of assumptions and was a matter of some complexity.

14. It was at least implicit in Article XIV(B) that Public Service would calculate the new rates correctly and in good faith. Thermo's initial response to the Company's August 27, 2001 offer (*i.e.,* Thermo's October 18, 2001 letter) and the discussion which followed concerned possible errors in Public Service's calculation. We agree with the Recommended Decision that Article XIV(B) did not permit Public Service and Thermo to negotiate new capacity payment rates. However, the discussions which followed the August 27, 2001 letter were not such

negotiations. Those discussions concerned whether Public Service had correctly applied the specified methodology in calculating the rates for an extension. Nothing in Article XIV(B) precluded Thermo from raising questions regarding the correctness of Public Service's calculation. As noted above, it was implicit in Article XIV(B) that Thermo had the right to accept or reject *correctly* calculated extension rates. Therefore, if Thermo believed that the Company's initial calculation was incorrect, it had the right to raise questions involving the calculation.[7]

15. We note the Recommended Decision concluded (paragraph 72) that the capacity prices contained in the Third Amendment were properly calculated and calculated in good faith. Those prices were the ones agreed to by Public Service and Thermo in the February 8, 2002 letter. We also note that Thermo accepted Public Service's offer for an extension within the 180-day period specified in Article XIV(B). Given these facts, we conclude that Public Service and Thermo complied with the procedures for extending the 1985 agreement as set forth in Article XIV(B).

[7] Under the analysis in the recommended decision, Thermo had to flatly accept or reject Public Service's proposal in its August 27, 2001 letter, and anything short of total acceptance operated as a rejection. However, the language in Article XIV(B) and the law of option contracts do not support such an interpretation. The fact that Article XIV(B) allows 180 days for Thermo to accept or reject an offer indicates that a substantial amount of time was built in to ensure that the proper methodology would be employed. Further, it would be an absurd result if Thermo had no ability to enter discussions with Public Service if it failed to follow the correct methodology or misapplied the methodology in its original proposal.* As Thermo states in its brief, the law of option contracts required Public Service to hold open the offer for the entire 180-day period, and thus a response to the initial letter that was quite short of a rejection should not operate as one. *See Schreck v. T&C Sanderson Farms, Inc.,* 37 P.3d 510, 513 (Colo. App. 2001).

**See Atmel Corp. v. Vitesse Semiconductor Corp.,* 30 P.3d 789, 793 (a contract should never be interpreted to yield an absurd result).

F. Substantiality of Changes to the 1985 Agreement

16. The Recommended Decision also determined that the Third Amendment was a new power purchase agreement instead of an extension of the 1985 agreement, because it made significant changes to the 1985 contract. According to the Recommended Decision, these significant changes include: (1) The Third Amendment permits Public Service and Thermo to further extend the power purchase agreement beyond the ten-year extension at issue here; this converts the agreement from one with a known term to one with an indefinite term subject only to the mutual consent of the parties; (2) The Third Amendment does not specifically continue the provisions of the 1985 agreement; and (3) The Third Amendment now provides for submission of the amendment to the Commission for approval. Again, we agree with the arguments in the Exceptions and conclude that the Third Amendment does not significantly change the 1985 contract. As such, the Third Amendment cannot be characterized as a new contract.

17. The Exceptions point out that *Phoenix Power Partners, L.P. v. Colorado Public Utilities Commission*, 952 P.2d 359, 364 (Colo. 1998) sets forth the relevant test for determining whether a purported amendment to an existing power purchase agreement constitutes an entirely new agreement: An amendment which is "radically different" from the existing contract would constitute a new contract. In other words, if a purported amendment *substantially* changes an existing contract, it is a new contract. In the *Phoenix* case, after observing that a proposed amendment to a power purchase agreement changed the location of the subject generating plant, the method of generation, the level of capacity from the plant, and the applicable rates in the original contract, the court concluded that the amendment constituted a new contract.

18. We note that the 1985 agreement, in Article XIV(B), expressly envisioned the possibility of a five to ten-year extension at new capacity payment rates. The Recommended

Decision correctly holds that Article XIV(B) does not permit further extensions beyond the ten-year extension. As for the first purported significant change to the 1985 agreement cited by the Recommended Decision--that the Third Amendment authorizes further and unlimited extensions beyond the ten-year extension--Public Service and Thermo contend that the ALJ misinterprets the intent of that provision. The objectionable language cited in the Recommended Decision provides that, "[t]here are no provisions for extensions beyond the Extended Term, *except by mutual agreement of the Parties*" (emphasis added). The Exceptions argue that this provision merely clarified that, in contrast to the provisions of Article XIV(B) which gave Thermo the unilateral right to extend the power purchase agreement, after the Third Amendment both parties must agree to any further extensions of the agreement. Public Service emphasizes the testimony of witness Hyde that any further extensions will be entered into only if consistent with applicable resource procurement requirements in effect at the time.

19. We agree with the Exceptions that the language cited in the Recommended Decision does not authorize further extensions of the Thermo power purchase agreement *irrespective of any Commission rules and policies that may exist* in the future. To remove all doubt, we direct Thermo and Public Service to modify the above-quoted sentence in the Third Amendment to provide: "There are no provisions for extensions beyond the Extended Term."[8] This modification makes clear that any purchase of power from Thermo's UNC facility after the ten-year extension approved here will occur pursuant to a *new* power purchase agreement, not under any extension of the 1985 agreement.

[8] The phrase "except by mutual agreement of the Parties" will be deleted from the Third Amendment.

20. As stated above, the Recommended Decision also concludes that the Third Amendment significantly changes the 1985 agreement because it does not specifically continue the provisions of that agreement. The Exceptions, however, point out that Section 6 of the Third Amendment expressly states that the power purchase agreement remains in full force and effect, except as modified by the Third Amendment. Therefore, the Recommended Decision is incorrect in its finding. We agree with the Exceptions on this point.

21. As for the last change to the 1985 agreement cited by the Recommended Decision, that the Third Amendment provides for submission of the amendment to the Commission for approval, Public Service points out that regulatory approval provisions are frequently included in power supply contracts and amendments. In fact, prior amendments to the 1985 agreement were submitted to the Commission (under Advice Letters) for review. The Exceptions suggest that this provision does not substantially change the 1985 contract. We agree with this argument.

22. For the foregoing reasons, we find that the Third Amendment did not substantially change the 1985 agreement for the reasons cited in the Recommended Decision. Therefore, those reasons cannot support a conclusion that the Third Amendment was a new contract, instead of an extension of the 1985 contract.

G. Change in Capacity Pricing in the Third Amendment

23. In its Response to the Exceptions--this reason was not cited in the Recommended Decision--Staff offers an additional basis for concluding that the Third Amendment significantly changes the 1985 contract. In light of that significant change, Staff argues, the Third Amendment is a new power purchase agreement subject to Commission rules for power acquisitions, particularly the IRP Rules. Specifically, Staff argues that the Third Amendment

changes the method for making capacity related payments to Thermo from a $/kwh to a $/kw-month arrangement. This change, according to Staff, is significant and was not envisioned in the 1985 agreement.[9]

24. Staff points out: There is no dispute that the Third Amendment does change the way Public Service will pay Thermo for power generated from the UNC facility. Under the 1985 agreement, specifically Article II(A), Public Service initially made capacity payments on a $/kw-month basis. That arrangement was changed under the provisions of Articles II(B) and (C). Those provisions of the 1985 agreement explain that Public Service preferred that Thermo operate the facility for extended hours on a regular basis, to increase the delivery of Metered Energy Output and Metered Capacity Output. Under Article II(B), Thermo was required to obtain a Prevention of Significant Deterioration (PSD) operating permit from the United States Environmental Protection Agency. That permit would enable Thermo to operate the facility for extended hours. Thermo did obtain that permit. According to Article II(C), after the issuance of the PSD permit Thermo was required to operate the facility for extended hours. Public Service would then discontinue capacity related payments under the Article II(A) method ($/kw-month pricing) and begin payments under the Article II(C) method ($/kwh pricing). Staff emphasizes that under the 1985 agreement Public Service now pays Thermo capacity related charges expressed in $/kwh.

[9] Thermo argues that Staff is collaterally estopped from challenging the Third Amendment because it failed to object to the 1985 agreement in the proceeding, Case No. 6645, where the Commission determined that Thermo was legally entitled, under PURPA, to a power purchase agreement with Public Service. The concise answer to this argument is that the arguments Staff raised to the Third Amendment could not have been raised in the prior proceeding. Therefore, the doctrine of collateral estoppel does not apply here. *See Bebo Const. Co. v. Mattox & O'Brien, P.C.,* 990 P.2d 78, 85 (Colo. 1999) (for an issue to be actually litigated and collateral estopped to apply, the parties must have raised the issue in the prior action).

25. Staff points out that the Third Amendment abandons the $/kwh pricing arrangement (Article II(C)) and reverts to the $/kw-month pricing arrangement (Article II(A)). Staff notes that payment on a $/kwh basis gives Thermo an incentive to operate the facility at a high capacity factor, essentially to operate it like a baseload plant. In contrast, with payment on a $/kw-month basis--a fixed capacity payment during specified hours--Thermo could reduce generation during certain periods without incurring a financial penalty. Essentially, Thermo will have an incentive to operate the facility like a peaking plant. Staff argues that this change in pricing methods alters the benefits of the Thermo power purchase agreement to ratepayers, and constitutes a significant modification to the 1985 agreement. Accordingly, the Third Amendment is a new contract, not an extension of the 1985 contract.

26. In response, Public Service and Thermo contend that the Third Amendment changes the pricing method for the contract extension because this is what was required by Article XIV(B). The parties point to the language in Article XIV(B) that the capacity payment rate for the extension period "shall be computed pursuant to Article II(A)." And, as noted above, Article II(A) requires a $/kw-month pricing arrangement for capacity payments.

27. Staff disputes the Company's and Thermo's interpretation of Article XIV(B). Staff points out that Article XIV(B) simply requires that capacity rates for the extension period "be *computed* pursuant to Article II(A)" (emphasis added). That language does not state that capacity payments shall be *paid* under the Article II(A) method. Staff notes that, in any event, a new capacity payment rate would need to be computed as an intermediate step in stating new kwh rates for any extension period. Therefore, the language cited by Public Service and Thermo is consistent with the possibility of $/kwh pricing under Article II(C). Staff then observes that Article XIV(B) required Public Service to state capacity payment rates in $/kw-month "or in

$/kwh" for any extension period. In short, the relevant provisions of Article XIV(B) of the 1985 agreement did not compel a reversion to Article II(A) pricing. Finally, Staff points out that according to Article II(C), once Thermo began extended hours of operation (under Articles II(B) and (C)), kwh pricing was to continue "thereafter." Nothing in the 1985 contract indicates that this pricing arrangement was to be discontinued for any extension period.

28. We agree with Staff that the 1985 agreement did not compel a reversion to $/kw-month pricing for capacity payments to Thermo, and, therefore, the Third Amendment does change the pricing method specified in the 1985 contract in a way not envisioned in the original contract. This, however, is not the end of the inquiry. The *Phoenix* case, *supra,* states the relevant test for determining that an amendment to a power purchase agreement constitutes an entirely new agreement: If an amendment *substantially* changes an existing contract, it constitutes a new contract. Therefore, the relevant inquiry here is whether the change in method for making capacity payments to Thermo substantially changes the 1985 agreement. We hold it does not.

29. The *Phoenix* case provides a point of comparison for considering the significance of the change made in the Third Amendment. There, virtually all components of the old power purchase agreement were changed by the purported amendment including the location of the generating plant, the method of generation, the capacity of the plant, and the applicable rates. That caused the court to conclude that the purported amendment was “radically different” from the existing contract. Here, only the method of paying for capacity from the Thermo facility is altered;[10] all other components of the power purchase agreement between Public Service and

[10] Of course the actual capacity rate is modified in the Third Amendment. However, that modification was specifically envisioned in Article XIV(B) of the 1985 agreement.

Thermo remain the same. The *Phoenix* case strongly suggests that the capacity payment change by itself is not so significant as to make the Third Amendment a wholly new power purchase agreement. We are unaware of any authority that a change simply in the method of paying for capacity from a facility constitutes a new power purchase agreement.

30. Staff's advocacy here is, in large part, based on its assertion that ratepayers will pay increased costs by the change in payment method contained in the Third Amendment, and, thus, will be harmed. The evidence, however, contravenes Staff's assertion. The only quantitative evidence in this record concerning the effect of the pricing change indicates that ratepayers will likely not be adversely affected. Company witness Hyde testified in rebuttal concerning the effect on ratepayers of reverting to the $/kw-month payment method. Using 2002 output from the Thermo facility and applying the $/kwh and $/kw-month methods, Ms. Hyde calculated that the Company (and ratepayers) paid substantially more for capacity from the Thermo facility under the $/kwh method than they would have paid under the $/kw-month method. Ms. Hyde's testimony indicates that ratepayers will probably benefit from the pricing change in the Third Amendment, as opposed to retaining the old method of paying for capacity from the facility. Thus, Staff's premise that the pricing change in the Third Amendment harms ratepayers is unsupported by the record.

31. For these reasons we conclude that the change in method of paying for capacity from the Thermo facility contained in the Third Amendment is not a substantial change to the 1985 agreement.

H. Reexamination of Price Versus Avoided Cost

32. At the May 6, 2003, oral argument to the ALJ in this matter, Trial Staff argued that, under 18 CFR § 292.304, the Commission can reexamine the price versus avoided cost

issue because a new legally enforceable obligation is being incurred in order to extend the contract for another ten years, and avoided costs are to be calculated at the time the obligation is incurred. Thermo responded that Staff's contention mixes up CFR subparts, and avoided costs are to be calculated at the time the obligation is first incurred.

33. We agree with Thermo on the substantial case law that a State commission cannot address the price versus avoided cost issue so long as the contract remains in effect. *See, e.g., Freehold Cogeneration Assoc. v. Board of Regulatory Commissioners,* 44 F.3d 1178, 1194 (3d Cir. 1995); *Independent Energy Producers Assoc. v. California PUC,* 36 F.3d 848, 858-59 (9th Cir. 1994); *Smith Cogeneration Management, Inc. v. Corporation Comm'n*, 863 P.2d 1227, 1240-41 (Okla. 1993). There is no case law that supports Staff's contention.

34. Certain facts cannot be avoided in this case. In 1985, the Commission approved the Thermo contract, including the option to extend the contract an additional ten years. The Commission was then aware of the perverse incentive agreement with respect to pricing and use of the Thermo facility that Staff now makes in this docket. In 1985 the Commission was bound to consider "[t]he terms of [the] contract or other legally enforceable obligation, including the duration of the obligation…," 18 CFR § 292.304(e)(2)(iii), and yet still approved the contract.

35. The Commission could have inserted language in its decision approving the contract that the price versus avoided cost issue would be reexamined at the time of the contract extension--but did not do so. (Indeed, it appears that, had the contract had a term of 25 years instead of 15, the Commission likely would have approved it.) Also, while Staff in 1985 made it clear that it did not want to be bound to the principles of approving the Thermo contract in other,

future cases, it did agree to the Thermo contract without any "reopener" language at the time of extension.

36. Since there is no new contract, and the Commission cannot reopen the price versus avoided cost issue, certain conclusions inevitably follow. Given that the ALJ found that the parties followed the correct formula to compute the price for the extended term--and no party agreed otherwise--the Commission must approve the Third Amendment. Further, the Commission cannot retroactively impose its 1996 IRP Rules on the 1985 contract.

37. We note that it is not necessarily wise policy to require State commissions to lock in prices for qualifying facilities that later become higher than avoided cost. But given federal statute and common law, we have no discretion in the matter. We hope, as did the Office of Consumer Counsel in its testimony, that Public Service may find a way to "buy out" the Thermo contract in a way that is advantageous to ratepayers.

I. Conclusion

38. This record fails to persuade us that the Third Amendment significantly changes the 1985 agreement. Staff's advocacy, in part, is that any capacity purchase from Thermo is unnecessary and, therefore, is harmful to ratepayers. However, we agree with Thermo and Public Service that the 1985 agreement itself provided for an extension of the contract. We conclude that Thermo properly exercised its rights under the 1985 agreement to extend its contract with Public Service, and the Third Amendment represents a permissible extension of the

1985 agreement. Therefore, we approve Public Service's application and the Third Amendment.[11]

II. ORDER

A. The Commission Orders That:

1. The Motion for Leave to Reply to Staff's Response to Exceptions by Thermo Power and Electric, Inc., is granted.

2. The Exceptions to Decision No. R03-0687 by Thermo Power and Electric, Inc., are granted consistent with the above discussion.

3. The Exceptions to Decision No. R03-0687 by Public Service Company of Colorado are granted consistent with the above discussion.

4. The Application for Approval of Third Amendment to the On-System Power Purchase Agreement between Thermo Power and Electric, Inc., and Public Service Company of Colorado is granted consistent with the above discussion.

5. The 20-day period provided for in § 40-6-114, C.R.S., within which to file applications for rehearing, reargument, or reconsideration begins on the first day following the Mailed Date of this Decision.

6. This Order is effective on its Mailed Date.

[11] It appears to us that Section Q (page 2) of the Third Amendment (*i.e.,* the definition of "Extended Term") contains a typographical error. We believe the reference to "Article II(A)" should be "Article II(G)." Our approval of the Third Amendment assumes this change to the agreement.

B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING August 13, 2003.

(S E A L)

ATTEST: A TRUE COPY

Bruce N. Smith
Director

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

GREGORY E. SOPKIN

POLLY PAGE

JIM DYER

Commissioners

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