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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for authority to adjust its electric rates effective August 1, 1984. (Electric)	Application 84-04-028 (Filed April 6, 1984; amended May 16, 1984)

(For appearances see Decision 84-08-118.)

INTERIM OPINION

Interim Decision (D.) 84-08-118 in this proceeding authorized Pacific Gas and Electric Company (PG&E) to revise its electric rates under its Electric Cost Adjustment Clause (ECAC), Electric Revenue Adjustment Mechanism (ERAM), and Annual Energy Rate (AER) procedures.

The issues remaining to be resolved are those associated with PG&E's annual reasonableness review for both its gas and electric departments. In the initial phase of this proceeding evidence was adduced by PG&E and our staff on the reasonableness issues. Resolution of reasonable review issues (other than inventory fuel oil sales) was deferred to this decision, in order to expedite the interim decision on ECAC, AER, and ERAM issues.

PG&E introduced Exhibit 37 in the initial phase of the proceeding which contains the settlement agreement between PG&E and Chevron U.S.A., Inc. (Chevron) resolving a civil court suit with respect to contracts entered into by PG&E and Chevron for the sale and purchase of fuel oil and for gas transmission to Chevron facilities. D.84-08-118 stated that the effect of the Chevron settlement payments on ECAC and AER revenue requirements would be based on the additional evidence adduced in this phase of the proceeding. Further hearing limited to the Chevron contract settlement agreement issues was held on August 13, 14, 22, and 28, 1984 before Administrative Law Judge (ALJ) John W. Mallory in San Francisco. The matter was submitted subject to the receipt of concurrent opening briefs on September 7, 1984 and concurrent closing briefs on September 14, 1984, which have been filed.

Reasonableness Review

The reasonableness period under scrutiny in this proceeding is February 1, 1983 through January 31, 1984. During that period there was an abundance of hydroelectric energy and natural gas. The winter in the record period was the second consecutive wet winter in northern California and the Pacific northwest, resulting in more than usual hydroelectric energy. In that period the Organization of Petroleum Exporting Countries lowered the benchmark price of crude oil, and domestic and other foreign oil producers followed suit. Natural gas suppliers reacted by changing their pricing policies. These were the major pricing considerations faced by PG&E's fossil fuel management in the record period.

Investigation of Reasonableness Issues

PG&E and our staff prepared and presented detailed analyses of PG&E's electric and gas operations in the record period. These analyses were received in evidence as PG&E's Exhibit 5 and staff Exhibits 6, 14, and 15 (electric) and 8 and 22 (gas). Applicant's exhibit covers all phases of its electric and gas plant operations and fuel purchase strategies during the record period. Based on its detailed showing PG&E asks that we find its operations in the record period were conducted in a reasonable manner.

Scope of Staff Investigation

The staff investigation and analysis in this proceeding were the most extensive ever conducted in a PG&E ECAC, AER, and electric and gas reasonableness proceeding. Twenty-three staff members, including one attorney, five accountants, and one analyst from the Revenue Requirements Division, and sixteen engineers and analysts from the Utilities Division, contributed to the effort. Every conventional steam power plant was investigated on-site by staff engineers. Areas covered included:

Hydroelectric Generation
Power Purchases
Dispatching
Fossil Fired Generation
Geothermal Generation
Minimum Thermal Generation Requirements
Pacific Northwest Transmission Intertie Utilization
Cost and Unaccounted for Energy
Cogeneration
Fuel Prices
Fuel Management
Rate Design
Revenue Allocation
Sales
Gas Sequencing
Gas Plant Operations

In addition, the Revenue Requirements Division accountants audited the ERAM account.

The staff, based on its review and analysis, found no reasons to recommend disallowances. The following recommendations are set forth in the staff report.

Electric Department

Use of Pacific Intertie

Between September 21, 1983 and October 7, 1983, an outage occurred in the Pacific Intertie when the Pacific AC Intertie towers were blown down, south of PG&E's load center. While the outage did not affect the amount of electrical power flowing into PG&E's system, it did reduce the amount of power flowing to SCE and SDG&E, thereby creating an excess situation. Staff queried PG&E as to why it did not purchase this excess power. PG&E asserted that the Pacific

Intertie Agreement did not allow any of the companies to buy more power than their allocated percentage (PG&E 50%, SCE 43%, SDG&E 7%). Utilities Division staff (UD) reviewed the contract entitled "CA Companies Pacific Intertie Agreement between PG&E, SCE and SDG&E" of August 25, 1966. The contract does not appear to preclude scheduling more power than PG&E's 50% share of the intertie, but states (on page 40): "No Company shall schedule deliveries of Northwest Power over the Company assured Intertie Capacity of any other Company or such other Company's transmission capacity referred to in (2) above without the approval of the Coordination Committee." PG&E has not shown that it asked the Coordination Committee for approval to use excess available capacity between September 21, 1983 and October 7, 1983.

PG&E is reminded that we will expect it to seek additional capacity on the intertie when it is beneficial to the ratepayers.

Losses and Unaccounted For Energy

Losses and unaccounted for energy constitute a large component (9.68% in PG&E's forecast and 9.15% in UD's) of PG&E's load. UD recommends that PG&E should undertake all cost-effective measures, within the limits of the expenditures authorized in general rate proceedings, to reduce lost and unaccounted for energy. Review of these measures is done in connection with general rate proceedings. Therefore, UD did not review the reasonableness of PG&E's actions to reduce lost and unaccounted for electricity in connection with this proceeding, although PG&E has programs designed with this goal in mind. UD recommends that both PG&E and the Commission, in the next general rate proceeding, consider substantial expansion of these types of programs to the extent it is cost-effective and otherwise feasible to do so.

The foregoing recommendation, while not strictly within the context of the reasonableness review procedure, should be adopted. The record indicates that the reasons for the substantial yearly variations in the amounts of losses and unaccounted for energy are unknown to the parties, and that the studies undertaken by PG&E have not, up to this time, pinpointed the reasons for such variations.

Items Carried Over From Previous Proceedings

In connection with this proceeding the staff reviewed ECAC related decisions going back as far as 1976. It specifically addressed all carried-over issues in this proceeding. The issues were:

The reasonablenss of 1982 payments made to the steam supplier for Geysers Unit 15.

The amount owed to PG&E for capacity sales to the Central Valley Project (CVP).

Recovery of recorded oil sales losses.

The heat rate standard adopted in D.83-08-057.

Settlement of litigation of facilities charges with Chevron.

Geysers Unit 15

Ordering Paragraph 3 of D.83-08-057 (the last annual reasonableness proceeding) states:

> "PG&E should be placed on notice that the fuel-related operations of Geysers Unit 15 during the April 1, 1982-January 31, 1983 review period and thereafter will be scrutinized in the next annual review to determine whether a penalty should be imposed for the low capacity factor of that unit, and to determine whether the low capacity factor was the result of an inadequate fuel supply."

Our staff examined the causes of Unit 15's low capacity factor with particular attention to the adequacy of the steam supply. The staff report states that, like other Geysers units, Unit

15 suffers from a wide variety of ills associated with impurities in the geothermal steam. In addition, it appears that at its location, near the edge of the developed steam field, there may not be enough steam to operate the unit at its full nameplate rating.

The staff report states that in order to correct problems affecting Unit 15's capacity factor PG&E has done the following:

1. Replaced with a longer lasting material leaking turbine steam seals that were contributing to the noncondensible gas problem.
2. Procured equipment to improve condenser efficiency by continuous cleaning. This installation appears to be nearly complete.
3. Procured-replacement fourth stage turbine blades for installation next fall.
4. Planned condenser modifications and increases in air ejector capacity to handle the present increased noncondensible gas levels in the steam. Installation is scheduled for 1986.

The report further states that, unless other breakdowns occur or there is a further increase in noncondensible gases, these modifications should enable the unit to develop its rated output if sufficient steam is supplied. Almost from first operation, steam availability at this location has been disappointing. Both PG&E and its steam supplier, Thermogenics, have retained consultants to evaluate the field and all parties appear to be cooperating in attempts to increase the steam supply. Thermogenics expended an amount nearly equal to its total revenue on drilling last year. If sufficient steam is not available in that part of the Geysers, there is a possibility steam could be brought from other parts of the field although this would involve obtaining easements across private property.

Under the steam supply contract, PG&E is not obligated to pay for steam supplied in any month when that steam is not adequate to maintain a 50% capacity factor. PG&E points out, however, that although the Unit 15 capacity factor was substantially below 50%, this was not due exclusively to a steam shortage.

UD asked PG&E to calculate what the capacity factor would have been if the plant could have efficiently utilized all the steam available. PG&E furnished data which showed that while the steam supplied in most months is insufficient to maintain a 50% capacity factor, it is often a close call. Staff states that, if PG&E attempts to recover payments made in those months, expensive and time-consuming litigation would probably ensue. The cooperative relationship with Thermogenics would be replaced with an adversary one. PG&E is Thermogenics' only customer. Staff believes that if PG&E obtained a judgment against Thermogenics the supplier might be unable to pay. In any event, if Thermogenics' steam sales revenue is cut off, it would be unable to continue drilling for long. PG&E has the option to undertake the drilling itself but there is no basis for assuming that PG&E could accomplish it at a lower cost to the ratepayer than at present.

The staff report states that the ratepayers' interest would seem to be best served by attempting to increase the steam supply until the limit of the field is reached and then operating the unit at whatever capacity can be attained. Staff recommends that the feasibility of bringing steam in from other fields should also be investigated should further drilling prove unproductive.

Staff concluded that PG&E appears to be exerting reasonable efforts to improve Unit 15's performance. UD found no imprudent actions on which to base a penalty. UD does not recommend that PG&E be encouraged to invoke the nonpayment provisions of the steam supply contract as long as the steam supplier continues to make a good faith effort to supply sufficient steam.

We agree with the staff conclusions. The operation of Geysers Unit 15 will be monitored by staff as part of its ongoing review of the reasonableness of PG&E's operations

<u>Capacity Sales to CVP</u>

The issue of the ratemaking treatment of revenues owed to PG&E for capacity sales to CVP should be held over to the next annual ECAC/AER and reasonableness proceeding pending resolution of the dispute between these parties as to the appropriate payment level (PG&E contends CVP's payments to it are too low). In D.83-08-057(Mimeo, p. 23) we adopted staff's recommendation that the amounts billed to CVP by PG&E be credited to the ECBA on an ongoing basis, subject to review by the Commission when the dispute between PG&E and CVP is resolved. PG&E should continue this crediting procedure; it should also keep E&C staff informed of any significant developments in this matter.

Oil Sale Losses

The appropriateness of sales of excess fuel oil in storage, both for the record period and the forecast period, was discussed in Interim D.84-08-118. In that decision we found that record period oil sales were reasonable. That decision also determined the appropriate interim ratemaking treatment for record period and forecast period oil sale losses. The decision indicated that, although a different method of allocating fuel oil losses between ratepayers and shareholders was adopted in that decision, we are still interested in using the approach described in D.83-08-057 in analyzing fuel oil sale losses in future ECAC proceedings. Thus, in Ordering Paragraph 3 of D.84-08-118, we directed PG&E, our staff, and Toward Utility Rate Normalization (TURN) to conduct informal workshops to develop a plan for implementing the D.83-08-057 "hold/sell option" approach to allocating fuel oil sale losses, and to file in this proceeding a written workshop report on or before November 1, 1984. At the hearing on August 28, 1984, PG&E requested that the filing of the workshop report be delayed to February 1, 1985 in order for PG&E, staff, and TURN to thoroughly analyze the factors involved.

D.84-10-006 issued October 3, 1984 suspended the operation of Ordering Paragraph 3 of D.84-08-118 until further order of the Commission, pending review and action on PG&E's application for rehearing and TURN's petition for modification of D.84-08-118.

Heat Rate Standard Adopted in D.83-08-057

The heat rate is a measure of the energy conversion efficiency of a steam-electric generating unit. It represents the amount of heat input in British Thermal Units (Btus) required to produce one kilowatt hour (kWh) of electrical energy. The higher the heat rate, the more input energy is required to produce the same output energy. In D.83-08-057 we adopted an annual heat rate (10,809 Btu/kWh) proposed by PG&E coupled, with a forecast containing more hydro than PG&E had projected, because we believed that with better maintenance and more efficient plant utilization the heat rate could be improved. Subsequently, in affirming that decision, in response to PG&E's Petition for Modification, we stated:

> "PG&E contends that the adoption of a heat rate which is lower than 1982 recorded levels is inconsistent with our adoption of a resource mix which contains less thermal generation than 1982 recorded levels. PG&E argues that if nonfossil resources are increased with a corresponding decrease in the thermal requirement, loading patterns will be affected, and it is reasonable to assume that the heat rate will suffer, i.e., increase. At first blush, PG&E's contention seems to have some merit. Nonetheless, it was our intent in D.83-0~~3~~8-057 to look beyond this narrow correlation. We stated then, and we reaffirm now, that we expect PG&E to devote sufficient resources to the operation of its electric steam plant system to reverse the trend of steadily worsening heat rates and to achieve a heat rate at least as good as that adopted for the forecast period. Therefore PG&E's request should be denied." (D.83-12-049, Mimeo, p. 5).

In the instant proceeding PG&E continued to dispute what it regards as the Commission's sole reliance on the system average heat rate as a measure of efficiency of PG&E's fossil units. PG&E submitted testimony indicating that a particular unit's heat rate is highly dependent upon the unit's load; thus as the load on the unit is decreased (e.g., due to increased hydro availability), the unit's heat rate will increase. According to PG&E, 67% of the 403 Btu/kWh difference between the adopted forecasted heat rate of 10,809 Btu/kWh and the recorded 1983 heat rate of 11,212 Btu/kWh is attributable to a decrease in utilization of conventional fossil units as compared to the forecast; the remaining 33% differential is "statistically insignificant", according to PG&E's testimony.

Staff agrees with PG&E that the system average heat rate standard is not a sole measure of how efficiently the plants are using fuel or of how well they are maintained. The staff report indicated that PG&E's tested heat rate, which is indicative of the operational heat rate should fossil fuel plants be used, improved slightly (on a average about 0.5%). The report states that given the level of effort displayed by the utility in the forecast period, the heat rate should improve in the forecast period. A forecast heat rate was adopted in D.84-08-118 which reflects the expected improvement.

To improve operations of conventional steam plants, which would also tend to improve heat rates, staff recommends that PG&E should increase the pace of modernization for monitoring and control, with the exception of the Kern Power Plant. It should also increase the use of personal computers for record keeping. At present, many of the records are hand tallied, making for laborious calculations and increased chance of errors. The staff recommends that PG&E should not be penalized for not meeting the heat rate standard set in D.83-08-057 and reaffirmed in D.83-12-049.

The staff's recommendations will be adopted, with the exception of its recommendation against a penalty.

In D.83-12-049 we explicitly recognized that the D.83-08-057 adopted forecast and heat rate were not entirely correlative. Thus the PG&E and staff testimony detailing the impact of increased hydro availability on a particular unit's heat rate presents us with no dramatic new insight; it merely repeats what we already noted in D.83-12-049, i.e., the heat rate will suffer if non-fossil resources are increased with a corresponding decrease in the thermal requirement. PG&E and staff have misread the tenor of our earlier decisions. Our clear purpose in adopting the 10,809 Btu/kWh figure was to provide a strong incentive to PG&E to devote its resources (and maintenance efforts) to thereby improve its steadily worsening heat rates. Apparently there has been slight improvement (0.5% on the average) in the heat rate tests of the fossil units operating at their rated capacity; however, there is no evidence in this proceeding that such an improvement has also occurred at loadings below rated capacity, where units are operated during times of low load or abundant non-fossil generation. Having established the standard, it is inappropriate now to ignore the fact for reasonableness review purposes that PG&E has failed to meet it. Nor has PG&E presented any affirmative evidence that it made a reasonable effort to try to achieve the standard, given hydro constraints. When an allowance is made for that factor, PG&E still has not met its burden of proof, since the only evidence it has presented merely reiterates the theme that it argued previously in A.83-34-19.

We also find unconvincing PG&E's testimony that 67% of the 403 BTU/kWh differential is due to decreased utilization of fossil units, as measured by the "output factor" of those units. This percentage is based on a correlation of output factor and system average heat rate based on data from 1977 through 1983 (Figure 3D in Exhibit 2). We question PG&E's use of 1983 data in establishing this correlation, because the correlation is then used to show the reasonableness of the 1983 system average heat rate. A correlation fit to 1983 data will obviously show that data to be reasonable; PG&E's reasoning appears circular. We note that a simple linear regression of the heat rate versus output factor data for 1979-82 in Table 3I of Exhibit 2 yields the result that only 25% (101 BTU/kWh) of the 1983 differential is due to decreased output factor. Thus PG&E's argument appears open to question. In view of the state of the record on this issue, we have insufficient information to calculate an appropriate disallowance at this time.

Since this application remains open anyway for consideration of the filing submitted by PG&E on the Economy Energy Sales Issue (D.84-08-118, Ordering Paragraph 2), we will require the Public Staff to file a disallowance calculation in this proceeding based on an appropriate formula such as the following:

$$\left[\begin{array}{l}\text{average}\\ \text{commodity}\\ \text{cost of}\\ \text{gas for the}\\ \text{period Feb. 1,}\\ \text{1983 thru}\\ \text{Jan. 31, 1984}\\ \text{\$/MMBtu}\end{array} \times \begin{array}{l}\text{Btu/kWh shortfall}\\ \text{based in comparison}\\ \text{of 10,809 Btu/kWh}\\ \text{and actual heat rate}\\ \text{for Feb. 1, 1983 thru}\\ \text{Jan. 31, 1984, as}\\ \text{adjusted for decreased}\\ \text{fossil unit utilization}\end{array} \times \begin{array}{l}\text{kWh generated during}\\ \text{period Feb. 1, 1983}\\ \text{thru Jan. 31, 1984}\\ \\ \\ \\ \\ \\ \end{array}\right] .91$$

The disallowance we ultimately adopt will be based on a differential, adjusted for hydro effects. Thus staff's calculation should highlight how much of the Btu/kWh differential is associated with a decrease in utilization of conventional fossil units as compared to the forecast, so that this amount can be eliminated from the disallowance calculation. Staff's calculation should be filed by January 31, 1985; PG&E and other appearances of record will be allowed to file responses on or before February 15, 1985. Our decision will issue thereafter.

Gas Department

As part of staff's prepared testimony on the reasonableness of PG&E's gas operations, it proposed a change in the regulatory framework that was intended to provide the company with an incentive to minimize its exposure to take-or-pay and minimum bill liabilities (Ex. 8, pp. 2-13 - 2-22). After strenuous objections by PG&E and Southern California Gas Company, the ALJ and assigned Commissioner determined that this matter should more properly be addressed in an Order Instituting Investigation (OII) (Tr. 658).

TURN urges the Commission to move expeditiously in issuing and scheduling hearings on the OII, as TURN believes the topics raised by the staff witness are ones for which time is of the essence, since renegotiations of long-term gas supply arrangements are either already in progress or at least imminent.

After further review, the Commission now concludes that the OII should not be issued at this time. Changes in Canadian government policies should produce reduced take-or-pay provisions for Canadian gas which, together with elimination of federal price controls, should force lower minimum bill provisions for purchases of El Paso gas. We will monitor these events with a view to opening an OII should our expectations prove erroneous.

The Chevron Contract

On May 16, 1984 PG&E and Chevron executed an Agreement of Compromise Settlement and Release (1984 Settlement Agreement) providing for a new fuel oil arrangement between PG&E and Chevron and also settling the pending litigation and all related disputes concerning PG&E's purchase of low sulfur fuel oil (LSFO) from Chevron. PG&E requests that the Commission find reasonable in all respects, and authorize PG&E to recover in rates, the full amount of payments provided for in and resulting from the 1984 Settlement Agreement. The revenue requirements contained in amended Application

(A.) 84-04-028, filed on May 16, 1984, included payments PG&E would make to Chevron through July 31, 1985 under the 1984 Settlement Agreement and the associated energy costs.

PG&E's request is an outgrowth of Commission proceedings held in 1982 and 1983, relating to the then pending disputes between Chevron and PG&E concerning LSFO purchase obligations. These proceedings are briefly summarized below.

In A.82-06-08 and A.82-06-20, PG&E and Chevron requested that the Commission validate an LSFO arrangement executed in early 1982 (the 1981 LSFO contract) and authorize PG&E to recover approximately $40 million in facility charge payments for the ECAC/AER forecast period beginning August 1, 1982. In D.82-12-109 we declined to authorize recovery of the facility charge payments called for under the 1981 LSFO contract on a prospective basis. We did permit PG&E to record future facility charge payments to Chevron in an ECAC balancing subaccount. We also declined to authorize an amendment to the Gas Purchase Agreement-Richmond Refinery (Gas Purchase Agreement Amendment) which was required to facilitate the Gas Transportation Agreement executed by Chevron and PG&E in 1982. The 1981 LSFO contract was conditioned on the receipt of authorizations necessary to implement the gas transportation.

Following D.82-12-109, the 1981 LSFO contract between PG&E and Chevron was abandoned and the parties resumed negotiations. Pending resolution of the contract disputes and a request for rate recovery, in PG&E's 1983 reasonableness proceeding (A.83-04-19; D.83-08-057), we again authorized facility charge payments, if any, made to Chevron during the intervening period to be recorded within an ECAC balancing subaccount.

On May 16, 1984, PG&E and Chevron executed the 1984 Settlement Agreement which was the subject of the further hearing. In amended A.84-04-028, PG&E has requested: (1) authority to adjust its electric rates in an amount sufficient to recover ECAC subaccount payments previously recorded or required to be made under the 1984 Settlement Agreement, (2) rate authorization of amounts which will be paid under the agreement during the ECAC/AER test period, (3) approval of the payments under that agreement to be made after July 31, 1985, and (4) recovery of additional geothermal steam payments resulting from the settlement.

The 1984 Settlement Agreement between Chevron and PG&E is made explicitly conditional upon receipt, not later than December 31, 1984, of approval from the Commission of the terms thereof and authorization by the Commission for PG&E to recover in rates the full amount required to carry out the obligations set forth therein. If such timely approval and authorization are not forthcoming, the 1984 Settlement Agreement will become null and void.

Additional evidence on the four issues described above was presented on behalf of PG&E, Chevron, and our staff. Those parties and TURN presented oral argument on the issues other than recovery of additional geothermal steam payments resulting from the settlement. That issue was briefed by PG&E, staff, and TURN.

PG&E's Evidence

PG&E, in Exhibit 35, presented the testimony of three witnesses to demonstrate the reasonableness of the Settlement Agreement and the associated rate recovery.

The testimony describes, from PG&E's standpoint, an overview of the events and circumstances leading to the restructuring of the 1976 PG&E/Chevron LSFO contract, as reflected in the 1981 contract, as follows:

Prior to 1972, PG&E's fuel oil requirements for power generation were low. Total consumption was no more than 1 to 2 million barrels of residual fuel oil per year and could be satisfied through short-term and spot purchases at relatively low cost. Beginning in late 1971, the combination of more stringent air quality standards in California and nationally resulted in increased demands for fuel oil with low sulfur content. Most refineries producing residual fuel oil during that period were not equipped with desulfurization facilities to meet this growing demand. Due to a variety of inhibiting factors, it did not appear that new refining capacity to produce requisite quantities of LSFO would readily be forthcoming.

At the same time as demand for LSFO was increasing, natural gas deliveries from El Paso Natural Gas Company, one of PG&E's principal suppliers, became subject to curtailment, and forecasts of future deliveries began to show a steady decline in gas availability. Projected supplies of California gas were similarly declining.

These factors caused PG&E to forecast in 1973 that its LSFO requirements for 1974 would be 44 million barrels, with ever increasing requirements amounting to 80 million barrels by the mid-1980s. Given these demand projections and the variables that were working against increased spot supplies of LSFO, it appeared that a significant gap would develop between LSFO requirements and projected supplies. After investigating the declining supply situation, the Commission, in D.81931, encouraged California utilities to enter into long-term fuel contracts necessary to secure the needed supplies of LSFO. PG&E responded to this direction and its own forecasted supply gap by entering into long-term LSFO contracts with ARCO and Union Oil Company of California. The quantities of LSFO available under those contracts were not sufficient to meet PG&E's projected LSFO demands.

PG&E's largest contract was entered with Standard Oil Company of California. (Its wholly owned subsidiary, Chevron, later became successor in interest under the contract.) Its structure and underpinnings were substantially different than PG&E's other LSFO agreements.

The 1976 LSFO contract provided for purchases of 15 million barrels of LSFO per year over a ten-year period - 1976 through 1985. PG&E believed that the length of this purchase commitment was a significant factor in securing Chevron's supply obligation. As of 1973-74, Chevron did not have the West Coast refinery capability to produce the quantities of LSFO required to be delivered under the contract. Because PG&E agreed to purchase 15 million barrels of LSFO per year over that ten-year period, Chevron agreed to commit significant capital to construct the facilities necessary to produce sufficient quantities of LSFO that would, at the same time, meet the stringent California air quality standards.

When the 15 million barrel purchase obligation under the 1976 LSFO contract was combined with the ARCO and Union Oil contract volumes, these three contracts would have provided PG&E annually with 26 million barrels of LSFO, still far less than the PG&E projected LSFO requirement of 35 million barrels for 1976. Even in 1976, this combined amount was perceived to leave sufficient latitude to adjust fuel purchases to changing gas availability and seasonal conditions. Similarly, when projected towards the 1980s, when LSFO use was forecasted to be 57 million barrels per year, the Chevron purchases were not perceived in 1976 to be likely to constitute a dominant segment of PG&E's future fuel policy. At the same time, given Chevron's extensive domestic petroleum position and its position as an influential member of ARAMCO, PG&E determined that of the major integrated refiners with whom PG&E might contract, Chevron offered the greatest capability to deliver necessary quantities of LSFO during difficult supply periods.

The mid-1970's period of declining gas supplies has not continued. The last years of that decade and the 1980s reflect a period of repositioning of LSFO as a supplemental and relatively expensive fuel. Although PG&E did burn 35 million barrels of LSFO in 1977, the need to burn high priced LSFO has rapidly diminished. Thus, while in March 1976 it was estimated that PG&E's 1983 demand for LSFO would be over 60 million barrels, the availability of hydroelectric generation, abundant natural gas supplies, and the combined effects of conservation and a sluggish economy have resulted in a dramatic reduction in requirements for LSFO. The primary use has been as a standby fuel to cover adverse circumstances when natural gas was curtailed for use in power plants. PG&E's total LSFO consumption for 1983 was only 1.2 million barrels. LSFO consumption for 1984 is estimated to be approximately 120,000 barrels.

In response to this changing need for LSFO, PG&E has continually reduced its LSFO purchase commitments and terminated them where possible and prudent. PG&E's ability to reduce purchases was constrained by the long-term commitments entered into in the early 1970s. Although PG&E negotiated limited underlift rights in 1978 and 1979, by late 1980 the LSFO problem was more pronounced. By early 1981 the problem of excess LSFO supplies had become a dominant feature of PG&E's fuels policy.

Faced with the diminishing LSFO requirements, Chevron and PG&E entered negotiations in early 1981 to adjust the contractual relationship. Those negotiations concluded with the 1981 LSFO contract which was presented to the Commission in A.82-06-08. That contract contained minimum and maximum purchase obligations which, although higher perhaps than optimal, were expected to be within PG&E's capability to utilize. In consideration of the additional fuel flexibility afforded by the 1981 LSFO contract, PG&E agreed to pay Chevron an escalating facility charge of approximately $36.75 million per year starting in 1981 and to transport specified quantities of natural gas for Chevron to its Richmond Refinery.

In March 1982, shortly after the execution of the 1981 LSFO contract, the Commission issued its Order to Show Cause (D.82-03-117) asking why it should not request PG&E to suspend purchases of LSFO. Subsequently in early April 1982, the Commission issued D.82-04-072 which requested PG&E to suspend LSFO purchases from Chevron. PG&E promptly complied with the Commission's request. That action substantially reduced fuel costs for ratepayers during 1982.

D.82-12-109, issued December 22, 1982, deferred action on recovery of prospective facilities charge payments and denied authority to implement the amendment to the Gas Purchase Agreement. Chevron and PG&E attempted, without success, to resolve the contract disputes which reemerged. Pending resolution of these contract disputes, PG&E suspended facility charge payments required by the 1981 LSFO contract.

In the summer of 1983, Chevron and PG&E again resumed discussions in an attempt to resolve their contract disputes. In conjunction with the resumption of those discussions, PG&E agreed to resume fixed cost payments which would have been called for under the 1976 LSFO contract. Those payments, which totaled approximately $11 million for 1983, continued to be made through September 30, 1983.

PG&E and Chevron were unable to resolve the disputes and negotiations reached an impasse with the parties approximately $60 million apart in positions. Thereafter, in October 1983 Chevron filed suit against PG&E and the Commission in the United States District Court for the Northern District of California, seeking declaratory relief and relief from breach of contract on the part of PG&E (Docket No. C-83-4638 MHP). As a result of that action, PG&E suspended all payments under the 1976 LSFO contract. Subsequently Chevron voluntarily dismissed this federal lawsuit.

Starting in early 1984, Chevron and PG&E resumed discussions to determine whether there existed a basis to resolve the disputes. There followed a series of negotiating meetings which resulted in the 1984 Settlement Agreement.

Effect of Settlement
Agreement on PG&E

PG&E asserts that the 1984 Settlement Agreement provides fuel flexibility in three ways. First, the 1984 Settlement Agreement imposes no minimum fuel purchase obligation on PG&E. In contrast, the 1981 LSFO contract had a minimum purchase obligation of 6 million barrels of LSFO for 1982-85 and lower minimums thereafter, and the 1976 contract, on its face, had no reduction flexibility whatsoever. The effect of the zero minimum purchase provision is that even though the contract term has been extended to 1989, PG&E has eliminated the risk usually associated with such term extensions that the fuel provided for may not be required.

Second, PG&E retains the ability to require Chevron to deliver full contract quantities. Thus, the 1984 Settlement Agreement provides PG&E with maximum flexibility to select the optimal supply source without relinquishing the supply security which the Chevron supply source represents. PG&E asserts that the ongoing supply obligation represents value received in the settlement, and PG&E and its customers can now approach the remainder of this decade with the reasonable assurance that fuel will be available if needed.

Third, PG&E also obtained LSFO supply source flexibility. Unlike the 1976 and 1981 LSFO contracts, the 1984 Settlement Agreement provides to PG&E complete freedom to purchase in the spot market. PG&E is now free to disregard the Chevron supply source and purchase LSFO on the spot market if prices warrant. As long as the price of such spot market LSFO is less than the Chevron contract price (net of the refund which would be due for payments made in advance under the 1984 Settlement Agreement on the barrels being purchased), the spot market will provide a viable market alternative to the Chevron contract. This allegedly allows PG&E to minimize the cost of any LSFO it may purchase.

The Settlement Agreement provides that at such time as PG&E may request Chevron to make deliveries under the contract, PG&E will pay the commodity and facility charge equivalent to that specified under the 1981 LSFO contract, minus a credit for the amounts previously paid pursuant to the 1984 Settlement Agreement on the barrels requested. The credit is initially set at $1.47 per barrel but escalates after January 1983 at the Consumer Price Index-Urban (CPI-U). For example, if PG&E were to purchase contracted LSFO from Chevron in August 1984, the credit would be approximately $1.57 per barrel. PG&E claims that the price to be paid for any LSFO purchased under the Settlement Agreement will be no greater than under the 1981 contract.

PG&E states that the 1984 Settlement Agreement also resolves a number of other pending contract issues in a manner favorable to PG&E and its ratepayers. The settlement releases PG&E, retroactive to October 1983, from an existing obligation to make monthly payments to Chevron for a pipeline across the Richmond Refinery and related facilities which Chevron constructed to allow direct LSFO deliveries between Chevron's Richmond Refinery and PG&E's Richmond pipeline terminus. The termination of this obligation will reduce PG&E's payment obligation to Chevron by approximately $7 million.

The 1984 Settlement Agreement also releases PG&E from the rquirement of purchasing make-up volumes of approximately 3,728,000 barrels of LSFO from Chevron at the end of the operable contract term. The make-up volume obligation was incurred in 1977-79 in return for the right to underlift contract quantities during that time period. PG&E asserts that the termination of this make-up volume obligation has a value to PG&E ranging from $4-11 million based on the cost of similar underlift payments.

The 1984 Settlement Agreement also serves to settle all claims asserted, or which could have been asserted, prior to the date thereof arising out of or related to performance, adjustment, or payments under the 1976 LSFO contract or the 1981 LSFO contract. For example, the agreement settles any and all claims by Chevron relating to LSFO underlifts in 1980 and reductions in, or suspension of, deliveries in 1981 and 1982 without any further payment by PG&E. PG&E asserts that the effect of the release of such claims is to lock in the fuel benefits previously made possible by the switch from LSFO to natural gas and other resources.

The 1984 Settlement Agreement specifically rescinds the Gas Transportation Agreement. PG&E estimates that this provision of the settlement will preserve substantial gas revenues which would otherwise have been lost. Chevron's estimate of the value to it of the Gas Transportation Agreement was approximately $134.5 million through 1989. PG&E estimates that for the period 1982-83 the minimum savings resulting from terminating the Gas Transportation Agreement were approximately $8.5 million based on the volume of transportable gas of Chevron from the fields covered by that agreement which were sold to PG&E.

PG&E's Evaluation of Litigation Risks

PG&E's evaluation of its exposure under Chevron's civil court action is as follows: Chevron's complaint against PG&E claimed damages of not less than $650 million under the 1981 LSFO contract, including $100 million as the value lost under the Gas Transportation Agreement. Subsequently, Chevron estimated that its damages under the 1981 LSFO contract ranged from $599-706 million depending on the assumptions made. Similarly, Chevron estimated that the range of damages under the 1976 LSFO contract was $429-715 million, depending again on the assumptions utilized.

PG&E evaluated the magnitude of potential damage awards by assessing various theories. PG&E's assessment of maximum possible liability under the various contract theories, although indicating substantial possible damages, varied somewhat from Chevron's. PG&E concluded that four litigation outcomes appeared to be within the range of probability under the circumstances. The realistic damage awards under those various outcomes ranged from $453-683 million on the pessimistic side to $37 million on the optimistic side, net of payments previously made and not including damages for failure to implement the Gas Transportation Agreement. There was a realistic risk that the upper range of damages might be awarded in the event of a finding of liability on the part of PG&E.

PG&E's evaluation was that the most likely range of award would require additional payments of between $84-206 million, exclusive of the costs associated with resuming payment of pipeline charges and similar issues resolved under the 1984 Settlement

Agreement. This award range also assumed that Chevron would not recover damages for breach of the Gas Transportation Agreement. Although PG&E believed that there was a possibility of a judgment which would require additional payments of only $37 million, that result would have required that the trial court determine virtually all significant issues in PG&E's favor. This result was not considered likely by PG&E in view of the ambiguities in the areas of contract law which were involved in the case and the uncertainties involved in calculating damages.

PG&E states that, in view of the range of possible outcomes, the cost per barrel at risk in litigation varied widely. At the high end, in the event Chevron was awarded damages in the amount of $583 million, the cost per barrel on the 70.6 million barrels which PG&E would have been deemed to have not taken in breach of its obligation would have been $9.68. If the amounts which PG&E has paid in the past relating to those volumes are figured in, the total underlift cost recoverable by Chevron would have been $10.61 per barrel. Under more limiting assumptions as to the magnitude of the per barrel losses suffered by Chevron (i.e., maximum damages of $453 million), the per barrel amount at risk in litigation was $6.40, or $7.34 if previous payments are included.

At the other end of the probable range, if it were assumed that PG&E's argument that its performance was excused as of April 1982 by virtue of a regulatory contingency would prevail, PG&E would be required to pay $3.7 million in additional fixed costs. The cost per barrel at risk on the 49 million barrels for which compensation would have been required under that theory would have been $.98. PG&E believes that, as reflected by this particular litigation assessment, there is little doubt that under virtually any legal theory PG&E would continue to have a payment obligation under the contract, even where actual LSFO purchases would be legally excused. This fixed payment obligation provided the capital support which justified Chevron's commitment to the LSFO project.

The intermediate range of damages assumed alternatively that the 1981 or 1976 LSFO contract was in effect but that PG&E would have been entitled to protection under the contingency clause only for periods after April 1982. Although even under these assessments the payments required would be significant, these cases more closely approximated what PG&E viewed as a likely outcome given the underlying contract structure. Thus, assuming that a court would find that the 1981 LSFO contract did in fact become effective but that the Commission's April 1982 decision requesting suspension of LSFO purchases was valid, the payment obligation resulting from the 79 million remaining contract quantity would have been $206 million, or $2.61 per barrel. This amount reflects the facility charges payment stream which remained under the 1981 LSFO contract. If underlift payments already made on those quantities are counted, the effective cost per barrel at risk increases to $2.75.

Using the same contingency assumptions, but applying the facts to the 1976 LSFO contract, lowers the cost per barrel at risk. In that situation, although PG&E would have been deemed to have breached the contract for periods prior to April 1982, fixed costs alone would have been payable under the 1976 LSFO contract after the Commission's April 1982 suspension request. The damage award under this situation was estimated by PG&E to be between $84-141 million, or between $1.20 and $2.01 on the 70.5 million barrels of LSFO for which Chevron would be due compensation. If partial underlift payments previously made on those volumes are included, the cost per barrel at risk under this approach ranges from $1.87 to $2.69. As with all the estimates in this area, these figures do not include the costs of litigation or the costs of obligations not otherwise excused under this approach, e.g., pipeline payments, gas transportation costs.

PG&E asserts that the damage exposure in those cases PG&E viewed as likely was, in most cases, well in excess of the $1.57 per barrel PG&E agreed to pay under the 1984 Settlement Agreement. PG&E also asserts that as it also obtains future supply benefits and flexibility under the 1984 Settlement Agreement the portion of the standby payments which represent the cost of the settlement is even lower.

PG&E's Evaluation of Reasonableness of Settlement - Return on Investment and Savings Analyses

PG&E also attempted to evaluate the merits of any possible settlement in terms of the extent to which the settlement payments required would provide Chevron with an appropriate level of compensation for its heavy investment in 1974-76 in its Richmond Refinery specifically made to meet PG&E's LSFO needs. PG&E also compared the settlement with the fuel savings which would be realized by PG&E and its ratepayers under various scenarios. PG&E states that the first approach, the return on reasonable investment analysis, provided a methodological approach which determined the range of settlement which it would propose or consider. The fuel cost minimization analysis provided a further check to ensure that the range of settlement justified under the investment analysis would also result in demonstrable positive benefits in terms of fuel cost savings.

Return on Investment Analysis

To analyze the approximate return on investment which Chevron could have reasonably expected to earn under the 1976 LSFO contract, PG&E first had to determine Chevron's capital investment. To determine the level of capital investment made by Chevron to modify the Richmond Refinery to produce PG&E's LSFO, PG&E hired Purvin & Gertz, a consulting firm with considerable expertise in refinery design and configuration.

Using internal Chevron documents, "LSFO Project Appropriations Requests" for the 1974 expansion project and Chevron's as-constructed design and assumed crude slate and refinery product slate, Purvin & Gertz determined the portion of the new process unit capacity which would have been required to produce the LSFO promised under the 1976 LSFO contract. By pro-rata allocation of the actual costs of the LSFO expansion project, Purvin & Gertz determined that the actual cost to Chevron of the capacity to be devoted to produce LSFO for PG&E, calculated as of January 1, 1976, was approximately $80 million out of a total capital expenditure of approximately $224 million, exclusive of working capital. The working capital required to support the inventory in process to PG&E was estimated at approximately $8 million in 1976, resulting in a total initial investment by Chevron of approximately $88 million.

Having determined the level of capital investment involved, PG&E proceeded to calculate a reasonable return. First, the internal rate of return Chevron would have anticipated based on the actual capital investment was calculated. For cash flow purposes, PG&E utilized the fixed capital charge of $1.324 per barrel which was included in the LSFO price under the 1976 LSFO contract. This component of the LSFO price was intended to provide Chevron with a return of and on its capital devoted to the contract. PG&E determined that Chevron's approximate expected rate of return on capital for the PG&E LSFO project, assuming PG&E had purchased full contract quantities through 1985, had been approximately 14.17%. Second, PG&E made a judgment that such a return rate was within the range of reason and did not provide Chevron with a windfall return, as it appeared that this rate of return was relatively low taking into account oil company target returns generally, and was apparently less than Chevron anticipated when it agreed to the project in 1973.

Utilizing the 14.17% return rate, PG&E then attempted to determine, based on actual purchases and underlift payments previously made, how much of the $88 million investment remained to be amortized. PG&E determined that as of April 1984 the capital payments made to Chevron had, under the assumptions stated, reduced the unrecovered investment to $63.7 million after giving effect to an assumed 14.17% return over the period January 1976-April 1984.

Given the magnitude of the unrecovered capital investment and the other fuel flexibility elements desired by PG&E in a potential settlement, PG&E then developed a proposal which was structured around a contract time frame extending through 1989. Using that basis, PG&E offered to pay over that period an amount which amortized a portion of the $63.7 million unrecovered capital investment based on a 14.17% return. The remaining portion of the undepreciated capital investment (which reflected assumed post-1984 salvage value) was amortized without a return.

After giving effect to the fixed operating costs to be incurred by Chevron during that extended contract period, PG&E thus proposed to pay Chevron approximately $137 million over the period 1983-89. Since Chevron's prior proposals had been translated into January 1, 1983 present value figures using a 5% discount rate, PG&E presented its proposal in the same form, resulting in a payment package with a comparable present value of $116 million.

Chevron strongly disagreed that the proposal provided adequate compensation for its damages. Chevron insisted that it was entitled to at least $171 million ($150 million, January 1, 1983 present value at 5%), but that it would accept not less than $161 million ($139 million, January 1, 1983 present value at 5%).

Thereafter, as discussions again started to break down, it became apparent that Chevron would highly value up-front payments, possibly to assist it in offsetting the cash effect of other corporate transactions which it was then pursuing. As such, it appeared that a settlement in the range suggested by PG&E may be acceptable to Chevron, provided PG&E would be willing to move more of the payments to the early years. PG&E responded that it was only willing to advance the payment stream if Chevron would accept a lower amount in settlement.

The 1984 Settlement Agreement reflects this trade-off and the value assigned to current payments by moving the vast majority of the $118.9 million in standby payments to the 1983-85 period. That payment structure in turn reduced the January 1, 1983 present value of the settlement to $110 million at a 5% discount rate. PG&E states that viewed more objectively from PG&E's cost of capital of approximately 13%, the January 1983 present value of the settlement is approximately $98 million.

PG&E's Fuel Cost Minimization Analysis

To provide an additional check on the reasonableness of any settlement, PG&E also analyzed the extent to which any settlement would generate or capture fuel savings. The fuel cost effects of the settlement were tracked through the fuel cost minimization analysis which was used to compare the estimated fuel costs which would be incurred by PG&E under various scenarios. Since PG&E assumed that any settlement would necessarily resolve past contract differences, the savings are reflected over the period 1981-89. Although the 1984 Settlement Agreement resolved 1980 disputed underlifts of approximately 1.8 million barrels of LSFO, the saving analysis does not incorporate the additional savings of approximately $22 million made possible by fuel switching in 1980.

PG&E asserts that the analysis shows that savings secured by the 1984 Settlement Agreement are substantial. Had PG&E continued purchasing LSFO under the 1976 LSFO contract at contract quantities for the period 1981-85, the resulting fuel costs associated with that strategy would have been $705 million higher than would be the case under the 1984 Settlement Agreement using the same assumptions. On a present value basis the comparison set forth in detail in Exhibit 35 assertedly shows that viewed as of January 1, 1983, using a 13% discount rate, the fuel savings secured under the settlement are estimated to be approximately $621 million, which is net of charges contemplated under the settlement and payments previously made in 1981-82.

PG&E argues that the $621 million savings under the settlement can be compared to the savings which would have been available had PG&E invoked the contingency clause under the 1976 LSFO contract, paid the fixed costs PG&E would argue were required under that circumstance, and then successfully defended the legality of its action in the litigation which would inevitably result of $700 million (present value as January 1, 1983 discounted at 13%), or approximately $80 million greater than under the 1984 Settlement Agreement. PG&E views that outcome as difficult at best to achieve, and believes that the 1984 Settlement Agreement, which obtains 89% of the possible savings under that situation, is clearly reasonable.

PG&E states that the fuel cost minimization analysis also demonstrates the benefits which were available under the 1981 LSFO contract as drafted, and as implemented following the Commission's April 1982 decision requesting that PG&E suspend LSFO purchases under that contract. PG&E claims that the analysis demonstrates that even under the 1981 LSFO contract the fuel cost savings, after giving effect to the facility charge payments thereunder, would have been $280 million. The analysis further reflects that the Commission's suspension request in April 1982 increased those savings to $577 million.

The reduced payments under the 1984 Settlement Agreement are reflected in the additional savings of $44 million (the difference between $621 million and $577 million). This analysis does not incorporate pipeline savings and possible refunds or credits in the future under the 1984 Settlement Agreement.

PG&E's Arguments As to the Reasonablenss of the Settlement Agreement

It is PG&E's view that, whether viewed from the perspective of litigation exposure, the return on capital investment afforded Chevron, or the fuel cost savings which will result, the 1984 Settlement Agreement represents an extraordinarily favorable resolution to an extremely difficult and potentially costly commercial dispute. There is a possibility that if the matter is litigated rather than settled on these terms the outcome to PG&E and its ratepayers might be less advantageous, perhaps significantly so, just as there is a possibility that it would be more advantageous. The 1984 Settlement Agreement must be viewed in that context.

PG&E asserts that it has systematically and realistically evaluated the litigation possibilities and has concluded that from several perspectives this settlement is reasonable and commercially justifiable. It results in substantial reduction in payment obligations to Chevron over those facing PG&E several years ago and yet provides PG&E with contract flexibility of a proportion unmatched in any other utility LSFO contract of which PG&E is aware. At the same time, the relatively modest payments, as viewed in the context of PG&E's overall fuel costs, provide reasonable fuel security for the future to the benefit of PG&E and its ratepayers.

PG&E urges the Commission to authorize PG&E to proceed with the 1984 Settlement Agreement fully in accordance with its terms.

Chevron's Evidence

Chevron presented as evidence through two witnesses, its manager, Planning and Analytical, for the Richmond Refinery, and its manager of the Commercial and Industrial Division of Chevron's Marketing Department. The latter witness was the principal negotiator for Chevron in settling its disputes with PG&E. Included with his prepared testimony (Exhibit 42) are a copy of Chevron's complaint filed against PG&E in the U.S. District Court in San Francisco, a chronology of the events underlying the dispute, and a statement of Chevron's views of the legal issues involved in the dispute.

The witness testified as follows:

Chevron calculated an estimate of the range of damages that Chevron has and will continue to incur as a result of PG&E's failure to purchase contract quantities of LSFO. These calculations ranged from a low of $599 million to a high of $706 million for the 1981 LSFO contract and from a low of $429 million to a high of $715 million for the 1976 LSFO contract. These calculations are based on computer runs made using a linear program model of the Richmond Refinery called the Generalized Refinery Optimization Program that is described in the prepared testimony of Chevron's other witness. After Chevron filed its complaint in U.S. District Court in October 1983 against the Commission and PG&E for declaratory relief, the parties began to explore the possibilities of settlement. At a meeting on February 16, 1984, Chevron made its initial settlement offer. Chevron estimated that this offer had a present value to Chevron of $150 million using a 5% value of money. This offer represented substantial concessions to PG&E since Chevron estimated that the total value of the facility charge payments under the 1981 LSFO contract and gas wheeling under the Gas Transportation Agreement was $304 million. PG&E made a counterproposal that provided for payment of $137 million through 1989. However, this counterproposal had a present value of only $116 million at a 5% value of money because substantial payments were not received until the final contract year. Chevron promptly advised PG&E their offer was unacceptable. Chevron was convinced that the $150 million offer was fair and equitable. However, Chevron was interested in settling rather than spending years litigating the matter at considerable expense. Chevron therefore reduced its demand and $139 million at a 5% value of money. PG&E rejected this second offer. At this point, the prospects for settlement were bleak. Chevron then commenced exploring various alternatives to determine if it could make any proposal that would be acceptable to PG&E.

During this time period, Chevron's parent corporation, the Standard Oil Company of California (now the Chevron Corporation), was negotiating acquisition of Gulf Oil Corporation. It was apparent that this acquisition would require substantial sums of money in the immediate future. Therefore, Chevron decided that it would be willing to settle for less money in present value terms if more of the payments were made in the early years of the contract. Chevron thereafter made a third offer to PG&E with a present value of $110 million at a 5% value of money. This third offer provided for payment of the entire sum during the years 1983, 1984, and 1985. Thus, a low settlement figure was offered for extrinsic reasons and not because Chevron felt its early offer was too high or that its complaint lacked merit. The offer has value to Chevron only if Chevron receives the payments promptly as scheduled and it will not be available in the future should this Settlement Agreement not be approved. Both PG&E and the staff of the Commission reacted favorably to this proposal. Thereafter there followed a series of marathon bargaining sessions in which the details of the final settlement were hammered out.

The witness described the basic terms of the Settlement Agreement as follows:

The Settlement Agreement provides that Chevron is obligated to supply 15 million barrels per year of LSFO through 1985 and 7.5 million barrels per year of LSFO during the years 1986 through 1989, but PG&E has no obligation to lift LSFO under this agreement. PG&E is obligated to pay Chevron $38.3 million per year for the years 1983 through 1985 and $1.0 million per year for the years 1986 through 1989. PG&E also agreed to pay Chevron approximately $3.0 million for interest on 1983 and 1984 past due amounts. If PG&E does buy oil under the contract, the price will be the facility charge plus the commodity charge (no change from previous agreements) less an escalating credit for $1.47 per barrel. This credit will escalate with the Consumer Price Index and compensate PG&E for the front-end loaded payment stream. The agreement is subject to approval by the Commission. If the Commission does not allow recovery of the full amount of payments in PG&E's rates, the agreement becomes void and Chevron will have one year from the date of the Commission decision or December 31, 1985, to return all payments plus interest to PG&E.

According to the witness, if the settlement is not approved, Chevron will live up to its obligation under the Settlement Agreement to refund PG&E's payments, and will proceed with due diligence to press its lawsuit against PG&E. Chevron expects that such an effort may take a number of years. Chevron firmly believes that it will be successful in its request for declaratory relief and will be entitled to collect compensatory damages in excess of the settlement amounts.

<u>Staff Analyses and Conclusions</u>

The Commission staff witness testified that the staff of the Commission's Legal Division and Public Staff Division attended most of the negotiating sessions between PG&E and Chevron and those divisions recommend that we approve the settlement, as it is the staff's view that the settlement is probably the least cost alternative to relieve ratepayers of obligations reasonably incurred at an earlier time under different circumstances. Staff concludes that the settlement would protect ratepayers from facing the results of a trial in Chevron's civil suit, with a possible judgment of $450 million.

In the staff's view the final settlement could not have been lower. The staff witness testified that there appear to be costs within the $122 million settlement that are not fully justified, particularly some part of the $48 million in fixed operating costs; but, on the other hand, the settlement is a compromise to avoid delay, expense, and uncertainty of a trial and was reached as a compromise of the counteroffers made by PG&E and Chevron.

The foregoing conclusions were supported by staff estimates of PG&E's exposure, as set forth in the following table:

Table 1

Commission Staff

Estimates of PG&E Exposure

Date	Description	Amount (Millions)*
April 1982	Facilities charge contained in 1981 contract and still owed when PG&E honored Commission request to suspend oil delivery	$207
October 1983	Chevron lawsuit	492 to 706
December 1983	Bargaining position of parties when negotiations resumed:	
	Chevron	150
	PG&E	92
March 1984	PG&E Assessments of Litigation Exposure:	
	Under 1976 contract:	
	Best possible outcome for PG&E	37
	Judgment for Chevron:	
	PG&E in breach until April 1982 suspension	84**
	PG&E in breach through 1985	453**
	Under 1981 contract:	
	Best outcome for PG&E	207
	Judgment for Chevron	307***
April 1984	PG&E offer	137 ($61 by 1986)
	Chevron counteroffer	161 ($95 by 1986)
May 1984	Settlement	122 ($118 by 1985)

*Nominal dollars in millions, not including interest.

**Plus consequential damages of $57-230 million.

***Including liability under Gas Transportation Agreement.

Based on its participation in the negotiations and its analyses of the possible outcomes should the civil suit proceed to trial, staff concludes that PG&E negotiators adequately balanced the potential value of alternate use credits available to them under the contract with possible consequential damages that could be awarded Chevron. Therefore, even with the questions about future operating costs not fully answered, staff believes that the Commission cannot conclude at this point that the Settlement Agreement is unreasonable, and should not be approved, unless it also concludes that (1) $207 million in contract facilities charges was too high in the first place, that (2) $122 million is still too high, and that (3) the exposure in the resulting litigation would not likely exceed $122 million. Instead, staff believes that the Commission should (1) recognize that the settlement was a compromise and that ratepayers are saving over $600 million in present value compared to the original contract, and (2) approve the settlement and rate recovery as proposed by the staff, <u>infra</u>.

<u>TURN's Position</u>

TURN's position, as presented in its opening statement, is that the $120 million settlement payment is not a reasonable cost for ratepayers to bear, but it probably is the best result that PG&E could achieve in the context of a pending lawsuit. TURN stated that it finds itself in the unenviable position of having to choose between acceptance of costs that TURN does not believe are really justified or risking that even greater amounts will be awarded to Chevron as a result of continued litigations. TURN believes that past inaction by the Commission, delaying the requirement that PG&E make public the terms of its fuel contracts that were initially considered confidential, and approval of the inclusion of facility charges in early ECAC decisions without public scrutiny of the underlying documents, was improper. TURN feels an opportunity that existed in 1982 and earlier to scrutinize the contracts has long passed and it is no longer viable for TURN to argue that PG&E would have a reasonable choice of winning a lawsuit over the terms of the 1976 contract; the 1981 agreement has been relied upon for too long to expect any great success in the attempt to resurrect its predecessor.

TURN further states that in the current Settlement Agreement PG&E has substantially improved its position in relation to the 1981 contract. TURN argues that the current agreement which requires 100% pass-through to ratepayers as a condition precedent to its effectiveness does not permit an assignment of any portion of the costs of settlement on PG&E's shareholders. Therefore, the $120 million settlement is the best that PG&E's ratepayers can hope for.

Discussion

The contract disputes between PG&E and Chevron have a long, complex history. It is with great care and consideration of this history that we come to our decision issued here today. Since we issued D.82-12-109, we have allowed PG&E to record its facility charge payments to Chevron in an ECAC balancing subaccount, but we have declined to authorize any recovery for these payments pending the outcome of negotiations between PG&E and Chevron. The Commission expressed its reasons for deferring rate recovery as follows:

> "[The] record leaves us in doubt as to whether PG&E has negotiated a facility charge at a level low enough to warrant recovery in full from its ratepayers...We are concerned that hasty approval of rate recovery for PG&E contract costs not clearly proven reasonable might mislead the parties to that litigation into anticipating our acquiscence in unrealistic terms of settlement." (D.82-12-109, 10 CPUC 2d 488, 501).

It is with the record before us today that we are finally able to determine the reasonable level of facility charge payments that PG&E can recover from ratepayers for the period covered by our D.82-12-109 through July 31, 1985.[2] As of December 31, 1984 PG&E estimates that it will have accumulated nearly $84 million in its

[2] Both D.82-12-109 and D.83-08-057, ECAC decisions covering the forecast periods August 1, 1982 - July 31, 1983 and August 1, 1983 - July 31, 1984, respectively, deferred the issue of rate recovery for facility charge payments to Chevron. This issue was therefore considered in this proceeding and it was part of the 1984 Settlement Agreement.

Chevron ECBA Subaccount. We will now consider the reasonableness of these payments and those projected for the current forecast period. As discussed previously, PG&E and the staff used three primary analyses to assess the reasonableness of the standby charges agreed to in the 1984 Settlement Agreement. We will briefly address each of these analyses below.

1. Litigation Risk Analysis

The parties in this proceeding gave substantial weight to their assessment of litigation risks. We do not believe that this assessment should carry such weight in this instance. First, there was an extremely large range in estimates of awards which might result if the PG&E-Chevron dispute was litigated to judgement. This casts significant uncertainty over the value of the analysis. Estimates of litigation risk ranged from $37 million to $715 million. Ignoring the extremes, PG&E's own evaluation of the most likely range of awards was between $82 and $206 million. The litigation risk analysis contains such a wide range of estimates that we have difficulty in finding it probative as a test of the reasonableness of the 1984 settlement.

A second reason for regarding the litigation risk analysis with some skepticism is that the estimates of awards rely upon contracts and actions taken by PG&E not clearly proven reasonable and hence, the resulting estimates of awards may not be especially relevant for our consideration of ratemaking treatment. For example, in D.82-12-109, we expressed doubts over the level of facility charge payments agreed to by PG&E in the 1981 LSFO contract. If we were now to find that these facility charge payments were unreasonably large and should not have been agreed to by PG&E, then PG&E's litigation exposure resulting from these facility charges would not be a legitimate risk for ratepayers to bear. Unreasonable actions taken by a utility should not impose costs on its ratepayers. Therefore, the relevant issue for this Commission to consider is whether PG&E agreed to a reasonable level of standby charges in the 1984 Settlement Agreement. We find the two remaining analyses somewhat more helpful in this regard.

2. PG&E's Fuel Cost Minimization Analysis

According to PG&E, the 1984 Settlement Agreement will save ratepayers $621 million (present value as of January 1, 1983 using a 13% discount rate) compared to purchasing contract quantities of LSFO for the period 1981-1985 under the 1976 LSFO contract. The Settlement Agreement is also projected to save ratepayers $44 million over the cost of suspending purchases for the period April 1982 through 1989 under the 1981 contract. On the other hand, the fuel cost minimization analysis shows that if PG&E had successfully invoked the contingency clause under the 1976 LSFO contract, ratepayers would have saved $80 million compared to the 1984 Settlement Agreement. While it is debatable whether PG&E should have attempted to invoke the contingency clause under the 1976 LSFO contract, PG&E did invoke a similar contingency clause under the 1981 LSFO contract. However, unlike the 1976 LSFO contract, the 1981 LSFO contract required the payment of substantial facility charges for a contingency invoked because of the availability of more economic alternate fuel. Therefore, invoking the contingency clause under the 1981 LSFO contract was arguably much more expensive to PG&E than it would have been to invoke it under the 1976 LSFO contract. If PG&E could have invoked contingency under the 1976 LSFO contract, then we wonder why PG&E agreed to large facility charges under the 1981 contract.

We continue to have the doubts we expressed in D.82-12-109 over the level of facility charges in the 1981 LSFO contract. The record now suggests that these facility charges were unreasonably high. Fortunately, we don't need to be overly concerned with this now since PG&E has negotiated a lower and more reasonable level of payments under the Settlement Agreement.

About the most telling conclusion we can draw from the fuel cost minimization analysis is that the 1984 Settlement Agreement is better than some, and worse than other alternate courses of action that were available to PG&E. The record does not enable us to determine which particular course of action is that which a reasonable utility would have taken. On balance, it appears that the 1984

Settlement Agreement is "in the ballpark", but we still have doubts over whether the $122 million in payments agreed to under the Settlement Agreement is as low as reasonably could be expected.

3. Return on Investment Analysis

PG&E's return on investment analysis suggests that the 1984 Settlement Agreement is reasonable because the settlement amount is less than the amount of compensation that Chevron deserved for its required investment in its Richmond Refinery. Staff, however, raises some questions about the analysis which leave us in doubt as to its validity. Staff questions the estimated $48 million for fixed operating costs and states that PG&E did not adequately justify this figure. Even with these questions, the staff went on to recommend approving the Settlement Agreement primarily because of PG&E's high litigation exposu H-wever, we have already expressed our doubts over the probative value of the litigation risk analysis.

Like staff, we wonder why PG&E should pay for the fixed costs of operating the refinery if they would be incurred regardless of LSFO production levels. There may be reasonable fixed costs which are incurred by Chevron for maintaining its facilities so that it can meet potential LSFO demand of up to 15 million bbls/yr, but we are not convinced that $48 million is a reasonable amount for such fixed operating costs. If this fixed operating cost component is overstated, then the 1984 Settlement Agreement does not appear to be such a good settlement for ratepayers.[3]

The 1984 Settlement Agreement resolves a long history and a long list of contractual disputes between PG&E and Chevron. The large number of factors considered in the Settlement Agreement, the uncertainty over contractual interpretations, and the controversy over the level of compensation that reasonably should be made to Chevron makes ratemaking evaluation of the Settlement Agreement difficult and complex. We have expressed some of our doubts over the

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3 Without fixed operating costs, the appropriate level of investment compensation to Chevron would be $126 less $48, or $78 million compared to $122 million for the Settlement Agreement.

reasonableness of the standby charges agreed to in the Settlement Agreement. We also realize that PG&E has made a considerable amount of progress in negotiating what it regards as a fair and reasonable contract with Chevron. We commend PG&E for its efforts. Nevertheless, we do not believe that it would be fair for ratepayers to bear the entire burden of standby charges agreed to in the Settlement Agreement.

This Commission and its predecessor Commissions have struggled with the adverse consequences of PG&E's LSFO oversupply condition. Ratepayers have borne substantial costs associated with this oversupply in the form of underlift fees, fuel oil sale losses, oil inventory costs, and rejection of cheaper alternate fuel. At the same time we have implemented ratemaking mechanisms designed to effect a ratepayer/shareholder sharing of the risks and costs resulting from this oversupply situation. For example, the Commission adopted a two-tier inventory approach to deal with the problem of excessive oil inventory. In D.83-08-057, the Commission stated:

> "It was not the intent of D.82-12-109 to distort PG&E's fuel use decisions. Rather, it was the intent to shift some of the burden of excessive fuel oil purchases to stockholders. That decision found that PG&E had <u>excessive fuel inventory levels that were in part caused by the company's fuel oil contract with Chevron USA, Inc.</u> (Chevron)). While not passing judgment on the PG&E-Chevron LSFO contract per se, we did conclude that <u>"we will begin to shift some (contract-related) expenses back to shareholders with the present intention of shifting more expenses in future years."</u> (D.82-12-109, p. 9). "A mechanism for explicitly shifting some costs back to the shareholder was the two-tier inventory approach that was adopted." (p. 12, emphasis added).

More recently in D.84-08-118, we adopted a 9%/91% allocation formula for sharing the risks of fuel oil sale losses between shareholders and ratepayers. One major reason for such risk sharing is that it provides proper incentives to utility management. It also mitigates some of the burden on ratepayers who have no control over the course of PG&E's fuel procurement practices.

After considering the specifics of the 1984 Settlement Agreement, the benefit of concluding litigation between PG&E and Chevron, our desire to provide utility management with proper incentives, and our lingering doubts over the reasonableness of the full $122 million in standby charges, we believe that some risk sharing is appropriate. We will adopt a 9%/91% risk allocation between shareholders and ratepayers, respectively, for standby charges agreed to under the 1984 Settlement Agreement. As mentioned previously, this is the same risk sharing formula adopted in D.84-08-118 for allocating fuel oil sale losses.

At this point we should clarify that we do not want to discourage utilities from entering into reasonable long-term fuel supply contracts. We will not disregard the benefits of long-term contracts such as fuel supply reliability. However, we do want to provide utilities with incentives to negotiate long-term contracts in the best interest of ratepayers and to carefully balance the costs and benefits of such long-term agreements. We also expect utilities to consider possible benefits to short-term fuel procurement strategies.

We are fully aware that our decision to adopt a ratemaking approach which fails to pass all costs of the 1984 Settlement on to PG&E's ratepayers conflicts with Paragraphs 6 and 7 of that agreement, which reads in relevant part:

"6. This Agreement shall be null and void and of no force and effect (except paragraphs 8 through 12, infra), retroactive to the date of its execution, upon the occurrence of any one of the following events:

"(a) If a decision of the CPUC in this matter does not find this Agreement in all respects reasonable or does not authorize PGandE to recover in rates the full amount of the payments provided for herein, including recovery of the reasonable carrying costs of such payments if rate recovery is not contemporaneous with the payments; or

"(b) If a decision in this matter is not rendered by the CPUC prior to January 1, 1985; or "(c) If any part of the decision of the CPUC approving this Agreement is not affirmed in its entirety on appeal.

"7. This Agreement is unconditionally effective upon issuance of a CPUC decision not subject to further appeal finding this Agreement in all respects reasonable and authorizing PGandE to recover in rates the full amount of the payments described herein, including recovery of the reasonable carrying costs of such payments if rate recovery is not contemporaneous with the payment. After such final decision has been made, this Agreement is not contingent on future CPUC actions."

However we are also aware that this provision, which attempts to constrain our ratemaking options vis-a-vis the Settlement (as well as the latitude available to the California Supreme Court on appeal (Par. 6.(c)), was inserted in the Settlement Agreement at the insistence of PG&E over Chevron's reservations that such a clause would unduly complicate the ratemaking review process (Tr. 847). Chevron's reservations were well founded, for we have previously rejected the notion advanced by TURN in A.83-04-19[4] that any final settlement of the dispute be contingent in any manner on our prior

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[4] In A.83-04-19 TURN proposed this following Ordering Paragraph be inserted in D.83-08-057

Proposed Ordering Paragraph

"PG&E shall immediately file a report with this Commission and serve copies on all interested parties if there are any significant developments in the negotiations with Chevron. Any agreement that requires PG&E to pay money to Chevron shall contain the following clause: 'This agreement shall not become effective until the California Public Utilities Commission has authorized PG&E to recover in rates all payments provided herein.'" (Page 21, Concurrent Opening Brief of TURN.)

ratemaking approval. We are firmly on record as being desirous of keeping our ratemaking options open in this area (D.83-11-063)[5]

In discharging our responsibilities to PG&E's ratepayers, we are necessarily required to disregard the coercive tone of the "null and void" language in arriving at a decision which properly balances the equities between shareholders and ratepayers. For if

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5 In April 1982 in D.82-04-072 we stated "It should also be understood that the Commission reserves the right to exercise its authority to disallow for ratemaking purposes all unreasonably incurred expenses of the utility's operations. This could, of course, include expenses incurred by PG&E as a result of the Chevron contract, including facilities charges (8 CPUC 663, 666).

In D.83-08-057 (Mimeo pp. 47, 51) we found that:

> "8. Review of PG&E's LSFO contract with Chevron was carried over to this proceeding from the last annual review proceeding (D.82-12-109). Contract negotiations between PG&E and Chevron are still under way and will not be concluded in he near future. The reasonableness of the provisions of the Chevron contract, including the facility and underlift charges, cannot be determined until the contract provisions are finalized."

We also concluded in D. 83-08-057 that ECBA subaccount treatment was not a guarantee of full recovery:

> "6. PG&E should be placed on notice that the ratemaking treatment under which it accumulates Chevron facility charges in a ECBA subaccount does not guarantee that it will recover all, or any portion, of the payments actually made to Chevron. The record developed to date (see D.82-12-109) should be incorporated into PG&E's next reasonableness review."

regulated utilities were able to predetermine the ratemaking treatment to be accorded their contractual decisions simply by inserting such language in their contracts, this Commission's regulatory authority would be severely diminished. The simple fact is that recognition of the null and void clause would not only have an adverse precedential effect but would be totally at odds with our constitutional and legislative mandate to ensure that rates are just and reasonable.

We regret the fact that the null and void clause may have had a chilling effect on the reasonableness review process. However, we will not under any circumstances abrogate our responsibility and allow unreasonable burdens to be placed upon ratepayers. We see no reason why PG&E could not renegotiate a new agreement with Chevron similar to the 1984 Settlement Agreement absent conditions requiring one hundred percent pass-through or otherwise impinging on our authority to determine fair and reasonable rate recovery. However, should PG&E's management choose to litigate further with Chevron in the hope of receiving a judgment more favorable than the Settlement Agreement, we now place PG&E on notice that its shareholders, and not ratepayers, will be at risk for the expenses and outcome of such further litigation.

There is one final aspect of our contract review policy that needs discussion at this time. Although we have necessarily reviewed the Settlement Agreement in its entirety, we will not authorize or explicitly prejudge the reasonableness of standby charge expenses beyond the forecast period. This is not to say that we will not consider the value of the Settlement Agreement as a whole. However, it is our policy to re-assess the reasonableness of contracts during each review period, if necessary, due to changed circumstances. As our predecessor Commission stated in reviewing the 1981 Contract:

> "PG&E's theory that once it is determined that it entered into a reasonable and prudent contract, its shareholders are absolved from all risks, is not correct in that it neglects the very important factor of changed circumstances.

> Whether or not a contract should remain in effect, be abrogated, or be renegotiated should be decided by utility management. It seems obvious that normally utility management will consider a change in the status quo only when there is an incentive for it to do so. If we pass through all expeneses without determining their reasonableness simply because they have been contracted for, there would never be an incentive for utility review of such expenses. Our review of the reasonableness of contract expenses with the possibility oif disallowance provides management incentive to incur only reasonable costs." (Decision 82-12-109 10 CPUC 2d 488, 492-493).

Additional Revenue Requirement

In postponing the Chevron issues to this phase of the proceeding, the Commission indicated to the applicant and parties that if it found reasonable the terms of the Settlement Agreement, PG&E's ECAC and AER would be further adjusted to provide for recovery of the additional revenue requirement.

In Exhibit 36, PG&E proposed a revised method of recovering the additional Chevron-related revenue requirement. In that exhibit PG&E proposed to recover $138.2 million using a 12-month balancing account amortization. The ECAC portion is approximately $133.4 million and the AER portion is approximately $4.8 million. Staff, on the other hand, proposed a seven-month balancing account amortization, producing a revenue requirement of approximately $198.8 million, comprised of an ECAC recovery of $194.0 million and an AER recovery of $4.8 million. Both proposals assume a January 1, 1985 date as the start of the recovery period for the Chevron-related additional revenue requirement.

The following tables set forth a comparison of the rate recovery proposed by PG&E and staff (Exhibit 44):

Table 2

Authorized Chevron-Related
Revenue Requirement Comparison
(Assumes a January 1, 1985 Revision Date)
($000)

Line No.		12-Month Amortization PG&E	Staff	Difference
1	Geothermal Steam Plants	$ 15,943	$ 1,443	$14,500
2	Standby/Settlement Charges	38,300	38,300	0
3	Subtotal	54,243	39,743	14,500
4	Less 9%	4,882	3,577	1,305
5	Subtotal	49,361	36,166	13,195
6	Allocated to CPUC @ .9763	48,191	35,309	12,882
7	Chevron Account Balance Estimated for December 31, 1984	83,989	83,514	475
8	Subtotal	132,180	118,823	13,357
9	Adjustment for FAU Expenses @ 0.00937	1,239	1,113	126
10	Annualized ECAC Revenue Requirement	133,419	119,936	13,483
11	AER Amount @ 9% (from line 4) (11)	4,882	3,577	1,305
12	Allocated to CPUC @ .9763	4,766	3,492	1,274
13	Adjustment for FAU Expenses @ 0.00937	45	33	12
14	Annualized AER Revenue Requirement	4,811	3,525	1,286
15	Total Annualized Chevron-Related Revenue Requirement	$138,230	$123,461	$14,769

Table 3
Annualized Chevron-Related
Revenue Requirement Comparison
(Assumes a January 1, 1985 Revision Date)
($000)

Line No.		7-Month Amortization PG&E	Staff	Difference
1	Geothermal Steam Plants	$ 15,943	$ 1,443	$14,500
2	Standby/Settlement Charges	38,300	38,300	0
3	Subtotal	54,243	39,743	14,500
4	Less 9%	4,882	3,577	1,305
5	Subtotal	49,361	36,166	13,195
6	Allocated to CPUC @ .9763	48,191	35,309	12,882
7	Chevron Account Balance Estimated for December 31, 1984	143,981	143,167	814
8	Subtotal	192,172	178,476	13,696
9	Adjustment for FAU Expenses @ 0.00937	1,801	1,672	129
10	Annualized ECAC Revenue Requirement	193,973	180,148	13,825
11	AER Amount @ 9% (from line 4) (11)	4,882	3,577	1,305
12	Allocated to CPUC @ .9763	4,766	3,492	1,274
13	Adjustment for FAU Expenses @ 0.00937	45	33	12
14	Annualized AER Revenue Requirement	4,811	3,525	1,286
15	Total Annualized Chevron-Related Revenue Requirement	$198,784	$183,673	$15,111

As may be seen from the above tables, the principal difference between staff and PG&E, in addition to the amortization period, is the geothermal steam rate.

Geothermal Steam Rate

The price that PG&E pays for geothermal steam (geothermal steam rate) to its four steam suppliers is determined by long-term contracts executed in 1970 and 1973 with its geothermal steam producers. The contract provisions are uniform (the Union Oil Company agreement was introduced as Exhibit 41). The contract sets forth a formula which indexes the geothermal steam rate to the changes in PG&E's cost of fossil fuel and nuclear generation. The rate is determined for each calendar year based on fuel costs for the prior year.[6]

The relevant part of the contract reads as follows:

> "...the average annual cost to PG&E's Electric Department in cents per million British thermal units (Btu) of fossil fuels used by all its steam-electric power plants (excluding any coal-fired plants owned by PGandE and located outside California) in the preceding calendar year..." (Ex. 41, p. 17.)

No further definition of any of these terms appears in the contract.

PG&E contends that the components historically included by it in determining the geothermal steam rate should govern the determination of that rate. PG&E's witness testified that facility charges paid under its LSFO contract were a component in past adjustments. PG&E contends that the standby charge payments to Chevron under the Settlement Agreement are in lieu of facility charges; therefore, those payments should be considered a "cost to PG&E's Electric Department...of fossil fuels" and should be used as a component of the formula used to adjust the geothermal steam

6 The interim decision adjusted the geothermal steam rate for all factors except the change resulting from the Settlement Agreement.

rate.[7] PG&E appears to believe that if it does not include standby charge payments in its steam rate, steam producers may be in a position to successfully sue for breach of contract; and that if the geothermal steam contracts are renegotiated, PG&E may be subject to higher steam payments than under present contracts. PG&E, therefore, urges that its interpretation of the quoted contract provisions be adopted.

Staff, on the other hand, places a different interpretation on the contract provisions and their historical application. The staff witness testified that, in his opinion, the standby charge payments under the Settlement Agreement are not the same as the facility charge payments included in prior geothermal steam rate adjustments as the Settlement Agreement encompasses more than facility charges, such as the settlement for the Gas Transportation Agreement. For this reason, the staff witness concluded that payments under the Settlement Agreement are not a "cost to PG&E's Electric Department...of fossil fuels." In issue in this disagreement is $14.8 million.

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7 PG&E witness Peters stated that in the past the company has implemented the geothermal contracts by including in the "cost of fossil fuels" those amounts booked to Account 151 of the Uniform System of Accounts--"Fuel Stock." Underlift fees and facility charges paid to Chevron in past years have been included in that account and incorporated into the steam price formula; oil inventory carrying costs have not. Further, to the extent there is any difference, the "cost of fossil fuels" has been treated as the cost of fuel utilized in a given year, not the cost of fuel purchased. PG&E submits that there is no functional difference between the "standby charges" paid pursuant to the 1984 Settlement Agreement and the facility and underlift charges included in past geothermal price calculations.

Staff argued as follows:

The 1981 LSFO contract is retained with major modifications. PG&E has no minimum take obligation, but its maximum take under the 1981 LSFO contract remains unchanged, (some 75.625 million barrels). PG&E agrees to pay to Chevron $118.9 million between 1983 and 1989 subject to certain stated adjustments. The payments are cast in the form of a "standby charge of $1.57 per barrel on the maximum contract volumes (75.625 million barrels)..." for which PG&E receives credit for each barrel of oil in fact purchased. While PG&E characterizes the standby charge as similar to the underlift and facilities charges under the superseded contracts, it seems more appropriate to recognize the $1.57 per barrel charge as a means of numerically quantifying the credit to PG&E for each barrel purchased, since $1.57 x 75.625 (maximum barrels of take) = $118.73 million, the total amount payable by PG&E under the settlement. It is not a facilities or underlift cost designed to reimburse Chevron for its investment to provide PG&E fuel oil. This is so because the Settlement Agreement does not identify the settlement amount as reflecting or equating Chevron's unrecovered investment in facilities. In fact, the facilities charges in dispute as of April 1982 were $207 million, an amount in excess of the total settlement. One settled agreement, the Gas Transportation Agreement, has no apparent relevance to fossil fuel costs to PG&E's Electric Department. The litigation and claims which are settled involved a variety of exposures to PG&E, including not only contractual amounts alleged due Chevron, but other components of damages and litigation-related expenses, which, as noted, exceed the level of facilities or underlift charges allegedly due Chevron.

The staff also argued that although PG&E uses Uniform System of Accounts Account 151, which lists items comprising the cost of fuel, as the basis for identifying the components of the geothermal price formula, settlement costs of litigation are not included in that account.

TURN's brief states that the Settlement Agreement requires that we must authorize "PG&E to recover in rates the full amount of the payments provided for (therein), including recovery of the reasonable carrying costs of such payments if rate recovery is not contemporaneous with payments..." In TURN's view this "all or nothing" clause severely limits the Commission's options and may require some form of rate recovery for certain costs not considered to be fully reasonable.

TURN's brief states that the Settlement Agreement resolves a number of different issues, including revocation of the Gas Transportation Agreement; that PG&E viewed the settlement of the Gas Transportation Agreement as having a significant economic value, and the costs of the Gas Transportation Agreement would not be an element in the geothermal price calculation if that agreement were in force. TURN states that there is no way of knowing whether PG&E is paying Chevron a larger amount that it would absent the Gas Transportation Agreement. TURN takes the position in its brief that there is no basis for any firm conclusion that the costs of the Chevron settlement represent a cost to PG&E's Electric Department of fossil fuels, as the costs of the Settlement Agreement may equally represent, at least in part, the cost of rescinding the Gas Transportation Agreement. If the latter is the case, TURN states that full recognition of the settlement payments in the geothermal steam pricing formula could provide an unjustifiable payment to steam producers.

PG&E argued that the staff witness has no legal training and little experience, if any, in the administration or interpretation of contracts and that his approach to the interpretation of the geothermal contract pricing formula violates almost every tenet of contract interpretation. PG&E's witness Peters, a member of the California State Bar, testified as follows (Exhibit 45):

"Few contracts contain explicit definitions of all terms. Accordingly, reasonable terms and conditions are often required to be implied or construed by the parties in order to further carry out their contract obligations. In this instance, the contract does not specifically define the phrase 'the cost to PGandE's Electric Department of fossil fuels.' Given that the contract language was drafted in 1958 as PGandE first launched its efforts to promote and develop geothermal resources, it is hardly surprising that the parties would have left certain terms imprecise rather than defining every term or concept in explicit detail. To the extent it may have even occurred to the negotiators that the phrase in question required a definition, the parties may well have concluded that it would be more appropriate to allow an evolution of this particular phrase by referencing it to the cost, however determined, which is allocated to the Company's Electric Department in the context of regulatory accounting and rate proceedings."

PG&E contends that the staff witness' analysis incorrectly juxtaposes the function of contractual language and the parties' intent. PG&E asserts that the language of a contract is intended to capture and memorialize the parties' intent on the terms and conditions on which they agreed. PG&E argued that in disputes, courts analyze the contractual language to determine the parties' intent citing Section 1636 of the Civil Code. In contrast, the staff witness suggests that the absence of an explicit requirement from the contract has legal significance superior to the parties' intent, and, in fact, the parties' intent is irrelevant to the question of contractual interpretation.

PG&E concluded that the staff witness should have investigated PG&E's prior application of the contractual terms in issue before reaching his conclusion, and his failure to do renders his interpretation invalid.

PG&E further argued that the parties' apparent intent, their prior practices, and the language of the contract provide competent evidence on the contract's interpretation. According to PG&E the evidence, presented by its witness Peters, showed that Union and Natomas, which own all but two of the operating geothermal units, maintain that the steam formula was intended to include the payments of the type to be made to Chevron in the geothermal pricing formula. PG&E asserts that the evidence shows the parties have included, and the Commission has authorized, rate recovery for the following expenses within the geothermal pricing formula:

1. Underlift fee payments (oil),
2. Facility charge payments (oil) and,
3. Minimum bill payments or take-or-pay payments to gas suppliers.

PG&E contends that the standby charges in the Settlement Agreement are similar to underlift charges or facility charges in the oil contracts. PG&E argued that the staff witness' failure to recognize that similarity and that the different names for the functions do not establish that the functions are different destroys his interpretation of the contracts.

Discussion

The disputed amount of $14.8 million in the revenue requirement results from different interpretation of a long-established geothermal contract pricing provision.

In arriving at our conclusions regarding this disagreement, we should first lay to rest the spectre raised by TURN that we must authorize an increase in the geothermal steam rate as proposed by PG&E or jeopardize the Settlement Agreement. First, the Settlement Agreement covers only those items in dispute between PG&E and Chevron. Payments made by PG&E to its steam suppliers are not the subject of the Settlement Agreement, nor do we envision that the parties in arriving at their Settlement Agreement even considered the geothermal steam payments as a recoverable item. Therefore, we do not believe that if we fail to authorize recovery of the change in the geothermal steam rate proposed by PG&E that we have placed the Settlement Agreement in jeopardy.

The task presented to us by staff and PG&E is to interpret the geothermal steam contract provisions. The historical application of contract provisions was by agreement of the parties, to which the Commission gave tacit approval by its acceptance of the changes in the geothermal steam rate changes in prior ECAC decisions. The parties included some items, such as facility or underlift charges,. in their calculations of the geothermal steam rate which are recoverable cost items in ECAC proceedings, yet some recoverable ECAC-related costs were excluded from the formula. Therefore, the fact that facility and underlift charge costs are recoverable in ECAC proceedings is not governing.

PG&E contends that the term "standby charges" used in the Settlement Agreement is the same as, and equates to, the terms "underlift charges" or "facility charges" used in the Chevron LSFO contracts. Staff disputes this rationale, pointing out that several issues in dispute were settled in the agreement, including the Gas Transportation Agreement on which a substantial value was placed by PG&E. The evidence, and the agreement itself, does not place a separate monetary value on the settlement of any particular agreement. Therefore, the staff contends that the so-called standby charge payments, as they represent the monetary payments due for settlement of all disputed amounts with Chevron, do not equate solely to settlement of underlift or facility charge payments due under the LSFO contracts. The staff argument is not persuasive that standby charge payments are not merely facility charge or underlift payments due under the LSFO contracts under a different name. The evidence adduced by Chevron and PG&E indicates that no specific monetary value was assigned to the Gas Transportation Agreement in their separate analyses of PG&E's exposure should the dispute go to trial. On the other hand, specific values were assigned to the underlift and facilities charges. The standby charges set forth in the Settlement Agreement produce substantially lower payments to Chevron than the contract underlift and facilities charges. Therefore, we can reasonably conclude that the standby charges in the Settlement Agreement equate to the underlift and facilities charges in the contract.

We turn to the issue of the intent of the parties to the contract. PG&E contends that, as the geothermal contract steam formula is couched only in general terms, we must rely upon historical practice and the intent of the parties to determine whether the standby charge payments under the Settlement Agreement should be used as a factor in the geothermal steam pricing formula. As the historical application of the geothermal pricing formula included underlift and facilities charges it is reasonable to include standby charges in the pricing formula. In keeping with our risk allocation of the Settlement Agreement standby charges, we find reasonable the increase in the geothermal steam rate resulting from the inclusion of 91% of the Settlement Agreement standby charges in the geothermal contract pricing formula.

Amortization Period

PG&E presented evidence in support of a 12-month amortization period for recovery of Settlement Agreement costs. The principal reason for PG&E's support of a 12-month amortization period is that the further rate increase would be recoverable from all ratepayers while, under a shorter period, some seasonal ratepayers (principally industrial customers) could escape from payment.

The staff, on the other hand, proposed a 7-month amortization period because a reduction in interest accruals would result from the shorter period, saving ratepayers about $2 million.

The parties characterize both proposals as reasonable, indicating that the Commission should elect whether it is more reasonable to spread the additional revenue requirement to all customers by use of a 12-month amortization period, or to save ratepayers approximately $2 million in interest costs.

We find that a 12-month amortization period for recovery of 91% of the costs resulting from the Settlement Agreement is reasonable because it ensures that seasonal customers bear some share of the rate increase and it ameliorates rate stabilization by spreading the rate increase over a longer time frame. A revision date commencing January 1, 1985 is also reasonable.

Based on our findings with respect to calculation of the geothermal steam rate, the amortization period for recovery of the Settlement Agreement costs, and our decision to allow recovery of only 91% of the Settlement Agreement standby charges, the following table sets forth the required revenue increases approved for the period January 1, 1985 through July 31, 1985:

Table 4

PACIFIC GAS and ELECTRIC COMPANY
Electric Department

Annualized Chevron-Related
Revenue Requirment
12-Month Amortization Period

($000)

1	Geothermal Steam Plants	$ 14,638*
2	Standby/Settlement Charges	34,853
3	Subtotal	49,491
4	Less 9%	4,454
5	Subtotal	45,037
6	Allocated to CPUC @ .9763	43,970
7	Chevron Account Balance Estimated for December 31, 1984	76,430
8	Subtotal	120,400
9	Adjustment for F&U Expenses @ 0.00937	1,128
10	Annualized ECAC Revenue Requirement	121,528
11	AER Amount @ 9% (from line 4) (11)	4,454
12	Allocated to CPUC @ .9763	4,348
13	Adjustment for F&U Expenses @ 0.00937	41
14	Annualized AER Revenue Requirement	4,389
15	Total Annualized Chevron-Related Revenue Requirement	$125,917

* Geothermal revenue requirement based on 91% of Chevron related costs equals .91 (15,943 - 1,443)+ 1,443 or 14,638.

<u>Findings of Fact</u>

1. Remaining for decision in A.84-04-028 are issues associated with the reasonableness review of PG&E's operation of electric and gas departments, during the period February 1, 1983 through January 31, 1984, and the reasonableness of the Settlement Agreement resolving a civil court suit with respect to contracts entered into between PG&E and Chevron for the purchase and sales of LSFO and for gas transmission to Chevron facilities.

2. The Commission staff made a comprehensive review of PG&E's operation of its gas and electric departments during the review period and, based on its review, staff presented its recommendations.

3. With the exceptions described below, PG&E's operations during the review period were prudent and reasonable.

4. The reasonableness of sales of excess fuel oil in storage during the record period and the appropriate ratemaking treatment for such sales was determined in interim D.84-08-118.

5. PG&E and our staff should be directed to present evidence in PG&E's next general rate proceeding with respect to additional programs designed to determine the causes of lost and unaccounted for electricity and to reduce such losses.

6. PG&E's actions in the review period with respect to operations of its Geysers Unit 15 were not unreasonable, but PG&E should report in its next reasonableness review the efforts of it and its steam supplier to obtain sufficient steam so that the Unit 15 capacity factor can be improved.

7. The issue of the amount owed to PG&E for capacity sales to CVP in prior review periods should be held over to PG&E's next reasonableness review proceeding because of current litigation.

8. PG&E should take the steps recommended by staff as outlined in the staff exhibits to improve operations of its conventional steam plants, with a view to improving the heat rate of such plants, and should report on its efforts in its next reasonableness review.

9. PG&E has failed to justify its failure to meet its forecasted heat rate during the period August 1, 1983 through July 31, 1984, taking into account hydro effects.

10. Other than those described in the preceding findings, there are no reasonableness issues which should be carried forward to PG&E's next reasonableness review.

11. A 9%/91% allocation of expenses between shareholders and ratepayers, respectively, is reasonable for the standby/settlement charges and the additional geothermal steam costs resulting from the 1984 Settlement Agreement.

12. The reasonable level of annualized revenues to allow PG&E for the standby/settlement charges and additional geothermal steam costs is set forth in Table 4.

Conclusions of Law

1. PG&E should be directed to implement Findings of Fact 4 through 8.

2. PG&E should be authorized to increase rates to recover the revenue requirement associated with the 1984 Settlement Agreement found reasonable in Finding of Fact ~~13~~ 12.

3. A disallowance should be imposed in accordance with the terms of this decision for PG&E's failure to demonstrate by clear and convincing evidence the reasonableness of its efforts to meet the heat rate standard established in D.83-08-057.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is directed to implement Findings of Fact 4 through 8.

2. PG&E is authorized to file with this Commission revised tariff shcedules for electric rates in accordance with this decision on or after the effective date of this order. The revised tariff schedule shall become effective not earlier than January 1, 1985, and shall comply with General Order 96-A. The revised schedules shall apply only to service rendered on or after their effective date.

3. This proceeding will remain open to consider the filings submitted by PG&E and other parties in response to Ordering Paragraph 2 of D.84-08-118. A decision will be issued in early 1985 on this matter.

4. This proceeding will also remain open for the consideration of the staff' calculation of a disallowance on the heat rate issue discussed in Finding of Fact 9 and Conclusion of Law 3, supra. Staff's calculation shall be filed on January 31, 1985; PG&E and other appearances of record shall be allowed an opportunity to respond on or before February 15, 1985.

This order is effective today.

Dated December 5, 1984, at San Francisco, California.

I will file a written dissent.
/s/ WILLIAM T. BAGLEY
Commissioner

DONALD VIAL
President
VICTOR CALVO
PRISCILLA C. GREW
FREDERICK R. DUDA
Commissioners

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz

Joseph E. Bodovitz, Executive Director

WILLIAM T. BAGLEY, Commissioner, dissenting:

The majority's decision to disallow rate recovery of 9% of the Chevron settlement amount has no basis in fact, is arbitrary in the full sense of the word, and thus has no basis in law.

The basic question before us, as reserved by this Commission in D.82-12-109 for later action, is expressed by that decision as follows:

> "'[The] record leaves us in doubt as to whether PG&E has negotiated a facility charge at a level low enough to warrant recovery in full from its ratepayers. We are concerned that hasty approval of rate recovery for PG&E contract costs not clearly proven reasonable might mislead the parties to that litigation into anticipating our acquiscence in unrealistic terms of settlement....' (D.82-12-109, 10 CPUC 2d 488, 501)." (Emphasis added.)

The majority opinion in this matter states at p.36:

> "It is with the record before us today that we are finally able to determine the reasonable level of facility charge payments that PG&E can recover from ratepayers for the period covered by our D.82-12-109 through July 31, 1985." (Emphasis added.)

Having twice posed the question of reasonableness, the majority totally ignores an answer. The fact is that there is no record on the subject of unreasonableness. Therefore there is not and cannot be such a finding. The further fact is that the settlement is acknowledged to be very favorable to PG&E and its ratepayers.

In D.84-12-026 issued this day involving San Diego Gas and Electric's oil supply contract with Tesoro, there had been such a finding and the Commission then proceeded to determine a "measure of damages". Actually determined was a measure of the amount not to be recovered made on the basis of arithmetical facts, after an earlier finding of unreasonableness. Here again, we have no such finding nor do we have any record facts upon which to base our "91/9" split or any other such split.

It is acknowledged that the majority - being arbitrary but not capricious - wished to "solve a problem" and wished to spread the risk of past oil supply uncertainty. The majority erects a facade of rationality by comparing the Commission's AER process (whereby fuel costs are borne on a 91/9 ratio) to this proceeding. But the analogy falls of its own weight. In the AER process we base-rate the 9 percent as an incentive for the utilities to operate more efficiently, i.e., prospective recovery of the 9 percent is possible. Here we are concerned with a reduction of a prior contract obligation, or past costs incurred. No incentive is involved and no additional recovery can be obtained. In such a costs incurred situation, return of such costs can only be disallowed if they were incurred or continued by unreasonable or imprudent action. The majority makes no such finding and thus the 9 percent disallowance is unauthorized.

/s/ WILLIAM T. BAGLEY, Commissioner

December 5, 1984
San Francisco, California

Staff agrees with PG&E that the system average heat rate standard is not a sole measure of how efficiently the plants are using fuel or of how well they are maintained. The staff report indicated that PG&E's tested heat rate, which is indicative of the operational heat rate should fossil fuel plants be used, improved slightly (on a average about 0.5%). The report states that given the level of effort displayed by the utility in the forecast period, the heat rate should improve in the forecast period. A forecast heat rate was adopted in D.84-08-118 which reflects the expected improvement.

To improve operations of conventional steam plants, which would also tend to improve heat rates, staff recommends that PG&E should increase the pace of modernization for monitoring and control, with the exception of the Kern Power Plant. It should also increase the use of personal computers for record keeping. At present, many of the records are hand tallied, making for laborious calculations and increased chance of errors. The staff recommends that PG&E should not be penalized for not meeting the heat rate standard set in D.83-08-057 and reaffirmed in D.83-12-049.

The staff's recommendations will be adopted, with the exception of its recommendation against a penalty.

In D.83-12-049 we explicitly recognized that the D.83-08-057 adopted forecast and heat rate were not entirely correlative. Thus the PG&E and staff testimony detailing the impact of increased hydro availability on a particular unit's heat rate presents us with no dramatic new insight; it merely repeats what we already noted in D.83-12-049, i.e., the heat rate will suffer if non-fossil resources are increased with a corresponding decrease in the thermal requirement. PG&E and staff have misread the tenor of our earlier decisions. Our clear purpose in adopting the 10,809 Btu/kWh figure was to provide a strong incentive to PG&E to devote its resources (and maintenance efforts) to thereby improve its steadily worsening heat rates. Apparently there has been slight improvement (0.5% on the average); arguably, but for this improvement the 403 Btu/kWh differential would have been greater. Having established the standard, it is inappropriate now to ignore the fact for reasonableness review purposes that PG&E has failed to meet it. Nor has PG&E presented any affirmative evidence that it made a reasonable effort to try to achieve the standard, given hydro constraints. When an allowance is made for that factor, PG&E still has not met its burden of proof, since the only evidence it has presented merely reiterates the theme that it argued previously in A.83-34-19. However, in view of the state of the record, we have insufficient information to calculate and appropriate disallowance at this time.[1]

Since this application remains open anyway for consideration of the filing submitted by PG&E on the Economy Energy Sales Issue (D.84-08-118, Ordering Paragraph 2), we will require the Public Staff to file a disallowance calculation in this proceeding based on an appropriate formula such as the following:

$$\left(\begin{array}{l} \text{average} \\ \text{commodity} \\ \text{cost of} \\ \text{gas for the} \\ \text{period Feb.} \\ \text{1, 1983 thru} \\ \text{Jan. 31, 1984} \\ \text{\$/MMBtu} \end{array} \times \begin{array}{l} \text{Btu/kWh shortfall} \\ \text{based in comparison} \\ \text{of 10,809 Btu/kWh} \\ \text{and actual heat rate} \\ \text{for Feb. 1, 1983 thru} \\ \text{Jan. 31, 1984} \end{array} \times \begin{array}{l} \text{kWh generated during} \\ \text{period Feb. 1, 1983 thru} \\ \text{Jan. 31, 1984} \end{array} \right) .91$$

1 We also note that the 403 Btu figure must necessarily be adjusted because it is based on the difference between forecasted heat rate (covering the period August 1, 1983 thru July 31, 1984) and the actual heat rate attained in calendar year 1983.

Intertie Agreement did not allow any of the companies to buy more power than their allocated percentage (PG&E 50%, SCE 43%, SDG&E 7%). Utilities Division staff (UD) reviewed the contract entitled "CA Companies Pacific Intertie Agreement between PG&E, SCE and SDG&E" of August 25, 1966. The contract does not appear to preclude scheduling more power than PG&E's 50% share of the intertie, but states (on page 40): "No Company shall schedule deliveries of Northwest Power over the Company assured Intertie Capacity of any other Company or such other Company's transmission capacity referred to in (2) above without the approval of the Coordination Committee." PG&E has not shown that it asked the Coordination Committee for approval to use excess available capacity between September 21, 1983 and October 7, 1983.

While not recommending disallowance, UD believes that the contract should be rewritten to allow full use of the available capacity whenever unused power is available.

While the evidence indicates that additional use of the intertie may be difficult to obtain because of changed policies of the Bonneville Power Administration (see Interim D.84-08-118, pages 13 and 14) we will direct PG&E to attempt to renegotiate the agreement referred to above, and to describe in its next reasonableness review the actions taken by it to acquire greater use of the intertie to transport excess economy energy available in the northwest.

Losses and Unaccounted For Energy

Losses and unaccounted for energy constitute a large component (9.68% in PG&E's forecast and 9.15% in UD's) of PG&E's load. UD recommends that PG&E should undertake all cost-effective measures, within the limits of the expenditures authorized in general rate proceedings, to reduce lost and unaccounted for energy. Review of these measures is done in connection with general rate proceedings. Therefore, UD did not review the reasonableness of PG&E's actions to reduce lost and unaccounted for electricity in connection with this proceeding, although PG&E has programs designed to expect any great success in the attempt to resurrect its predecessor.

TURN further states that in the current Settlement Agreement PG&E has substantially improved its position in relation to the 1981 contract. TURN argues that the current agreement which requires 100% pass-through to ratepayers as a condition precedent to its effectiveness does not permit an assignment of any portion of the costs of settlement on PG&E's shareholders. Therefore, the $120 million settlement is the best that PG&E's ratepayers can hope for.

Discussion

The contract disputes between PG&E and Chevron have a long, complex history. It is with great care and consideration of this history that we come to our decision issued here today. Since we issued D.82-12-109, we have allowed PG&E to record its facility charge payments to Chevron in an ECAC balancing subaccount, but we have declined to authorize any recovery for these payments pending the outcome of negotiations between PG&E and Chevron. The Commission expressed its reasons for deferring rate recovery as follows:

> "[The] record leaves us in doubt as to whether PG&E has negotiated a facility charge at a level low enough to warrant recovery in full from its ratepayers... We are concerned that hasty approval of rate recovery for PG&E contract costs not clearly proven reasonable might mislead the parties to that litigation into anticipating our acquiscence in unrealistic terms of settlement...". (D.82-12-109, 10 CPUC 2d 488, 501).

It is with the record before us today that we are finally able to determine the reasonable level of facility charge payments that PG&E can recover from ratepayers for the period covered by our D.82-12-109 through July 31, 1985.[2] As of December 31, 1984 PG&E estimates that it will have accumulate nearly $84 million in its

[2] Both D.82-12-109 and D.83-08-057, ECAC decisions covering the forecast periods August 1, 1982 - July 31, 1983 and August 1, 1983 - July 31, 1984, respectively, deferred the issue of rate recovery for facility charge payments to Chevron. This issue was therefore considered in this proceeding and it was part of the 1984 Settlement Agreement.

Findings of Fact

1. Remaining for decision in A.84-08-028 are issues associated with the reasonableness review of PG&E's operation of electric and gas departments, during the period February 1, 1983 through January 31, 1984, and the reasonableness of the Settlement Agreement resolving a civil court suit with respect to contracts entered into between PG&E and Chevron for the purchase and sales of LSFO and for gas transmission to Chevron facilities.

2. The Commission staff made a comprehensive review of PG&E's operation of its gas and electric departments during the review period and, based on its review, staff presented its recommendations.

3. With the exceptions described below, PG&E's operations during the review period were prudent and reasonable.

4. The reasonableness of sales of excess fuel oil in storage during the record period and the appropriate ratemaking treatment for such sales was determined in interim D.84-08-118.

5. PG&E should be required to report in its next reasonableness review on it efforts to obtain approval from the Coordination Committee to amend the Pacific Intertie Agreement so that PG&E may receive additional use of the intertie to transmit excess economy energy available in the northwest.

6. PG&E and our staff should be directed to present evidence in PG&E's next general rate proceeding with respect to additional programs designed to determine the causes of lost and unaccounted for electricity and to reduce such losses.

7. PG&E's actions in the review period with respect to operations of its Geysers Unit 15 were not unreasonable, but PG&E should report in its next reasonableness review the efforts of it and its steam supplier to obtain sufficient steam so that the Unit 15 capacity factor can be improved.

8. The issue of the amount owed to PG&E for capacity sales to CVP in prior review periods should be held over to PG&E's next reasonableness review proceeding because of current litigation.

9. PG&E should take the steps recommended by staff as outlined in the staff exhibits to improve operations of its conventional steam plants, with a view to improving the heat rate of such plants, and should report on its efforts in its next reasonableness review.

10. PG&E has failed to justify its failure to meet its forecasted heat rate during the period August 1, 1983 through July 31, 1984, taking into account hydro effects.

11. Other than those described in the preceding findings, there are no reasonableness issues which should be carried forward to PG&E's next reasonableness review.

12. A 9%/91% allocation of expenses between shareholders and ratepayers, respectively, is reasonable for the standby/settlement charges and the additional geothermal steam costs resulting from the 1984 Settlement Agreement.

13. The reasonable level of annualized revenues to allow PG&E for the standby/settlement charges and additional geothermal steam costs is set forth in Table 4.

Conclusions of Law

1. PG&E should be directed to implement Findings of Fact 4 through 9.

2. PG&E should be authorized to increase rates to recover the revenue requirement associated with the 1984 Settlement Agreement found reasonable in Finding of Fact 13.

3. A disallowance should be imposed in accordance with the terms of this decision for PG&E's failure to demonstrate by clear and convincing evidence the reasonableness of its efforts to meet the heat rate standard established in D.83-08-057.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is directed to implement Findings of Fact 4 through 9.

2. PG&E is authorized to file with this Commission revised tariff shcedules for electric rates in accordance with this decision on or after the effective date of this order. The revised tariff schedule shall become effective not earlier than January 1, 1985, and shall comply with General Order 96-A. The revised schedules shall apply only to service rendered on or after their effective date.

3. This proceeding will remain open to consider the filings submitted by PG&E and other parties in response to Ordering Paragraph 2 of D.84-08-118. A decision will be issued in early 1985 on this matter.

4. This proceeding will also remain open for the consideration of the staff' calculation of a disallowance on the heat rate issue discussed in Finding of Fact 10 and Conclusion of Law 3, supra. Staff's calculation shall be filed on January 31, 1985; PG&E and other appearances of record shall be allowed an opportunity to respond on or before February 15, 1985.

This order is effective today.

Dated DEC 5 1984, at San Francisco, California.

I will file a written dissent.
WILLIAM T. BAGLEY
Commissioner

DONALD VIAL
President
VICTOR CALVO
PRISCILLA C. GREW
FREDERICK R. DUDA
Commissioners