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Decision 88-07-058 July 22, 1988

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking Proceeding on the)
Commission's Own Motion to)
Revise Electric Utility Rate-)
making Mechanisms in Response)
to Changing Conditions in the)
Electric Industry.)

I.86-10-061
(Filed October 1, 1986)

ORIGINAL

OPINION ON PETITIONS FOR MODIFICATION

Petitions for modification of Decision (D.) 88-03-008 have been filed by the Division of Ratepayer Advocates (DRA) on April 7, 1988, and jointly by Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Southern California Edison Company (Edison) on April 19, 1988. Natural Resources Defense Council (NRDC) responded to DRA's petition on April 27, 1988, and the response also contained proposals for modification of D.88-03-008. DRA responded to the utilities' joint petition on May 4, 1988. Edison, the California Energy Commission (CEC), and PG&E responded to DRA's petition on May 6, May 17, and May 20, 1988, respectively.

Edison, PG&E, and SDG&E filed a second joint petition to modify D.88-03-008 on June 13, 1988. NRDC responded to the second joint petition on June 27, and DRA filed its response on July 1, California Energy Commission (CEC) filed on July 12, and the Department of General Services (DGS) filed on July 14.

In a related development, the workshop on conservation options called for in D.88-03-008 was held on June 2. A summary of the workshop was prepared by the moderator and mailed to all parties on July 8.

The initial joint petition included a proposal to change the transition date specified in D.88-03-008 from September 1, 1988, to January 1, 1989. That aspect of the joint petition has been addressed in D.88-05-072.

We will separately discuss each issue raised in the petitions.

I. The Definition of the Less Restricted Class

In its petition, DRA suggests that the decision should be modified to clarify that sales to all customers with demands of over 1,000 kilowatt (KW) will no longer be subject to the Electric Revenue Adjustment Mechanism (ERAM) after the transition date, regardless of a particular customer's potential to bypass the utility's system. At the same time, however, DRA argues that one exception should be made to this rule. DRA believes that sales to agricultural customers with demands of over 1,000 kW should continue to be included in ERAM and should be excluded from the less restricted class. DRA states that our desire to treat large agricultural customers differently from other large customers was shown in D.87-04-028, in which we directed PG&E to transfer large agricultural customers from the E-20 tariff to agricultural tariffs.

We intended in D.88-03-008 to include all customers with demands of 1,000 kW or more in the less restricted class, and sales to these customers would no longer be covered by ERAM after the transition date. However, the discussion in D.88-03-008 focused on whether or not the class should include smaller customers. Our concluding sentences therefore spoke of limiting the class to customers of 1,000 kW or more. We will make minor modifications to clarify our intent.

Edison opposed DRA's proposal to remove large agricultural customers from the less restricted class. Edison's TOU-8 schedule is based entirely on consumption characteristics and

not on what use is made of that consumption. Edison believes that the decision similarly defined the less restricted class in terms of consumption characteristics. Edison believes that it is consistent to treat all customers with large demands alike and to include all customers with demands of 1,000 kW or more in the less restricted class.

PG&E's response states without elaboration its support for DRA's recommendation.

Our action in D.87-04-028 resulted from a reorganization of rate design that had unexpected consequences for some agricultural customers. Our shifting of PG&E's very large agricultural customers from the E-20 schedule was not intended to express an opinion that these customers should be treated differently from other large customers in all respects, and we have not taken similar steps for the other utilities. For the present, we believe that the less restricted class should be defined by the size of the customer's demand, and not by the use to which the customer puts the electricity it purchases. We will not adopt DRA's proposed exception.

II. Modifications to the Conservation Guideline

In D.88-03-008, we adopted a guideline that required utilities to offer customers with whom they were negotiating special contracts an option of choosing programs to improve the efficiency of the customers' use of electricity instead of the full rate discount the parties would otherwise negotiate. The notion was that potential bypassers were primarily concerned with overall energy costs, and those costs could be lowered by conservation and load management as well as by rate discounts. DRA, NRDC, and the second joint petition proposed modifications to the decision's treatment of this topic.

A- DRA's Proposals

First, DRA asserted that it was unnecessary to develop the conservation menu, the list of approved conservation programs, called for in the decision. All that was needed to demonstrate the effectiveness of a particular proposal was for the utility to present the analysis specified in the Standard Practice Manual for Economic Evaluation of Demand-Side Management Programs, developed by the staffs of the Commission and the CEC. If a particular program passes the Total Resource Cost (TRC) test, then it should be approved. According to DRA, this procedure would assure that the efficiency options associated with special contracts would have the same economic footing as conservation programs approved in the utility's general rate case.

Second, DRA has several objections to the decision's provision that the conservation options for special contracts customers would be initially funded from "the utility's authorized conservation budget for programs designed to serve" the less restricted class (D.88-03-008, Conclusion of Law 15, mimeo., p. 48). DRA points out that the currently authorized programs are given designations no more specific than "nonresidential" or "industrial" and that it is impossible to determine which programs are designed to serve the less restricted class.

DRA's proposal for modification has five elements. First, DRA suggests that the use of authorized conservation funds should be subject to existing restrictions on the utility's discretionary movement of conservation funds. Second, funds for conservation options associated with special contracts customers should be limited to 25% of the authorization for nonresidential programs. Third, any request for additional funds should be by an application, not by an advice letter, as permitted by the decision. Such an increase should receive a more thorough scrutiny than advice letter filings ordinarily receive. Fourth, customers should be required to verify that any conservation or load management

equipment financed by the utility has, in fact, been installed. And fifth, the chance to choose conservation options instead of discounted rates should not be available for customers with contracts for incremental sales.

B. NRDC's Proposals

NRDC reacted to DRA's proposals and offered its own modification.

NRDC is disturbed by the lack of symmetry between the treatment of conservation options and rate discounts associated with special contracts. No limit has been proposed or imposed on the amount of the rate discounts that may be offered to customers threatening bypass, yet DRA has proposed a limit on the amount of the related conservation programs. NRDC believes that this asymmetry arises from a discomfort with the source of the funds for the two parts of the special contracts program. Once the forecast of revenues is established, rate discounts are financed by the shareholders, presumably in hopes of maximizing net revenues. Conservation options, on the other hand, are financed by ratepayers, resulting in the perception that a limit is needed.

NRDC proposes a funding arrangement that would lessen this asymmetry. Any conservation payments greater than the 25% limit proposed by DRA would be funded from "the increased net revenues generated by conservation-based special contracts." Since the conservation payment is limited to the net present value of the foregone rate discount, and since both conservation programs beyond the 25% limit and rate discounts would be financed by the utility's increased net revenues, the utility should continue to be indifferent about the customer's choice of rate discounts or conservation options.

NRDC also argues that reliance on the TRC test is unnecessary. The only test for a conservation option related to a special contract, in NRDC's view, should be whether the cost of the conservation program is less than the cost of the rate discount

that the utility and the customer would otherwise agree to. NRDC asks, "Would DRA really want utilities to reject a \$200,000 conservation payment on the basis of DRA's cost-effectiveness yardstick, when the alternative was a \$300,000 rate discount?"

Finally, NRDC opposes DRA's suggestion that the conservation guideline should not apply to contracts for incremental sales. NRDC believes that the decision is unambiguous and makes both anti-bypass and incremental sales special contracts subject to the conservation guideline. According to NRDC, the reasons for applying the guideline to anti-bypass special contracts apply with equal strength to contracts for incremental sales.

C. Edison's Position

Edison agrees with DRA that cost-effectiveness, and not whether a particular program is listed on the conservation menu, should be the test of the conservation and efficiency offerings a utility may make available to special contracts customers. Edison believes that a menu may quickly become outdated, and that the use of the term "conservation menu" neglects the important role that efficiency improvements play in retaining customers on the system.

Edison disagrees with the implication that the TRC test should be the primary test for determining which programs should be offered to special contracts customers. Edison believes that the TRC test cannot be used easily to test the efficiency of programs that increase electricity consumption, and Edison therefore recommends that programs that meet either the TRC test or the ratepayer impact measure should qualify.

Edison disagrees with the 25% limit proposed by DRA and recommends that funding requests for conservation options should be considered with each special contract. Since the Commission must eventually approve the contract through the Expedited Application Docket, it would be a simple matter to broaden this proceeding slightly to consider the request for the funding necessary to carry out the conservation options selected by the customer.

Edison agrees with DRA that customers who receive conservation incentive payments should have to verify that they have installed the equipment that the payment was intended to help finance.

Finally, Edison disagrees with DRA's proposal not to permit utilities to offer conservation options to customers with contracts for incremental sales. Edison believes that such payments may, in many instances, further the goals that the Commission has tried to pursue in this proceeding.

D. CEC's Position

CEC supports DRA's proposal for limiting the amount of authorized conservation funds that may be directed to special contracts customers as an interim solution to the question of how to finance the costs of conservation options provided to special contracts customers. CEC believes that this question should be addressed in more detail at the conservation workshop that was scheduled for June 2, 1988.

CEC opposes DRA's recommendation to drop the conservation menu approach in favor of case-by-case cost effectiveness testing. CEC suggests that the conservation menu should consist of programs that would be deemed "automatically cost-effective," and that only conservation options not on the menu would require individual cost-effectiveness test results. This approach would give many customers easy and inexpensive access to the programs on the list while allowing for new, innovative, or unique options to be pursued.

Finally, CEC urges the Commission not to decide the question whether conservation options should be made available to customers with contracts for incremental sales until it has received more complete information on the policy considerations and consequences of the decision. CEC believes that a workshop should be scheduled to consider this issue.

E. PG&E's Position

PG&E first urges expanding the concept of the conservation option to include all types of demand management programs, including load management options. A broader range of programs will improve PG&E's ability to tailor its conservation options to fit a particular customer's needs, and many load management programs are already available.

PG&E agrees with DRA that it is not practical to develop a generic menu of options, but PG&E joins NRDC in questioning the need for any cost-effectiveness tests for efficiency programs for special contracts customers. A special contract with a rate discount, PG&E argues, may be viewed as a conservation program with zero benefit, since the customer's consumption and load curve are unaffected. Why then, PG&E asks, should the conservation options, which result in consumption or load-shaping benefits and which are conceived as a substitute for rate discounts, be subject to a stricter test of cost-effectiveness?

Like other parties, PG&E opposes DRA's suggestion that conservation options should not be made available to customers with contracts for incremental sales.

On the question of financing the conservation options, PG&E asserts that the ERAM classes receive the benefit of retained or enhanced sales and should therefore provide the financing for the conservation options chosen by special contracts customers. PG&E thus opposes both DRA's and NRDC's proposals on financing the conservation options. PG&E also opposes DRA's suggestion that additional funding for conservation for special contracts customers should be requested by advice letter.

F. The Second Joint Petition

The joint petitioners assert that the decision should be modified to correct an inappropriate limitation on the programs that are referred to in the conservation menu. Some parties at the conservation workshop of June 2 read the decision to limit the menu

to standard conservation items; that is, measures that serve to reduce a customer's kilowatt-hour consumption. The joint petitioners believe, however, that in keeping with the purpose of this proceeding, a wider range of cost-effective efficiency options would be more useful in discouraging uneconomic bypass and in retaining large customers on the utility's system.

More specifically, the joint petitioners urge the Commission to expand the conservation menu to include four broad categories of energy efficiency options. These categories are conservation, load management, fuel substitution, and load building, and appropriate definitions are stated in Appendix A of the "Demand-Side Management Reporting Requirements Manual," developed by the Commission's staff.

NRDC opposed the utilities' proposal to include load building as part of the menu of conservation options. NRDC points out that D.88-03-008 showed the Commission's continuing concern about the long-term effects of the special contracts program. This concern is demonstrated by the determination that "the term of a special contract should not extend into any year when forecasts indicate that additional capacity will be needed to meet target reserve margins." NRDC argues that load-building programs are much harder to limit. The increased loads that result from any load-building program are likely to remain on the system when expensive new capacity is needed, and the eventual costs to the system and its ratepayers could outweigh any near-term gains.

DRA advanced similar arguments in opposing the utilities' proposal to include fuel switching and load building as conservation options. DRA also argues that this part of the second joint petition is premature and should be addressed in evidentiary hearings.

G. Discussion

Our conception in developing the conservation menu approach to future flexibility was to try to serve several goals at

once. Some of the utility's existing or newly developed conservation and load management programs would be offered to a targeted group of customers who, if they accepted the offers, would consume electricity more efficiently and would remain on the utility's system and pay rates higher than the fully discounted rates they would have otherwise negotiated with the utility. The conservation programs would not only meet the Commission's standards of effectiveness, but they would also withstand the customer's direct economic comparison with rate discounts. Although we referred to a conservation menu, we used "conservation" as an abbreviation for conservation and load management programs. Our intent was to serve the utility's interest by maximizing net revenue from the customer, to meet the customer's needs by lowering its total power bill, and minimize system generation costs, to serve ratepayers' interests by retaining on the system a customer who would otherwise be lost.

In terms of the clarification requested in the second joint petition, the programs referred to in the conservation menu should qualify as conservation or load management programs. We agree that the definitions stated in Appendix A of the "Demand-Side Management Reporting Requirements Manual" developed by our staff, with slight modifications to reflect this proceeding's focus on electricity, are appropriate:

"Conservation programs are defined as programs which have the effect of reducing consumption of electricity during most or many hours of operation of the equipment or building affected by the measure.

"Load management programs are defined as any program which reduces electric peak demand or has the primary effect of shifting electric demand from the hours of peak demand to nonpeak time periods."

We do not agree that fuel substitution and load building programs should be included in the options presented as part of the

conservation menu. Fuel substitution frequently presents difficult problems of cross-subsidization or cost-allocation between electric and gas ratepayers or questions of whether or not overall efficiency is furthered.

Similarly, as DRA and NRDC point out, load building seems to conflict with some of the goals of this proceeding. Obviously, by permitting the utilities to stimulate incremental sales by offering reduced rates, we have tolerated some short-term load building. As we clarified in the recent Edison general rate case (D.87-12-066, pp. 141-143), load retention, which is classified in the Appendix A definitions as load building, is an appropriate application of DSM funds. But in the present circumstances, our tolerance of load building goes no further. We can see no advantage to long-term load building, and we have limited the terms of incremental sales contracts to guard against the harms that incremental sales could otherwise inflict on the utility's system and its ratepayers. We also believe that under current circumstances it is inappropriate for the utilities to expend funds to encourage load building.

For purposes of defining eligible DSM alternatives (conservation and load-management) to a rate discount, we believe it appropriate to exclude fuel substitution and load building at this time. This is entirely consistent with the goals of this proceeding. Thus, for eligibility purposes, DSM alternatives should be compared to current consumption.

The analysis for cost-effectiveness of DSM, however, presents separate considerations. Different alternatives to bypass involve different costs and benefits which accordingly deserve appropriate treatment. Specifically, all conservation and load-management measures, when installed in lieu of bypass, must be evaluated against the proposed bypass technology. This will usually require a "fuel substitution" type of analysis (e.g., electric service with a DSM incentive compared to gas

cogeneration). This type of analysis is explained clearly in the Joint Standard Practice Manual.

The report of the conservation workshop indicates that many parties were confused about other aspects of the conservation menu. In particular, parties appear to have debated whether the menu was intended to be fixed or flexible and whether the menu was a necessary or even desirable feature of the conservation guideline. We do not believe that our original conception was as confusing as the parties have interpreted it to be or that our statements about the conservation guideline were as unclear as the parties have found them. Nevertheless, it appears that this proceeding will benefit from further explanation of our conception of the purpose and function of the conservation menu.

This part of the proceeding arose out of our concern about a growing number of customers who were bypassing the utility's system by developing self-generation capabilities. We determined that we could serve the twin goals of combatting bypass and making use of the utility's short-term excess capacity by permitting the utility to enter into contracts to sell electricity at less than the tariff rate to customers who could present a credible threat of bypassing the system. To comply with statutory requirements and to ensure that other ratepayers were not unreasonably harmed by these special contracts, we established a review process, the Expedited Application Docket (EAD), to allow quick approval of these contracts. To further speed up the review process of the less controversial contracts, we adopted a series of guidelines.

At the same time, however, we were concerned that the additional sales stimulated by these lower rates could accelerate the time when the utility would need to add capacity to meet its target reserve margin. The conservation guideline was an attempt to lessen this problem.

The conservation menu is an aspect of the guideline. It serves two interrelated functions. First, it provides the utility with a convenient way of initiating discussions with the customer about conservation and load management options. Second, it gives the utility a ready method of demonstrating that it has complied with the requirements of the conservation guideline, that it has offered certain conservation and load management programs to the customer in place of the negotiated rate discount.

Thus, we conceived of the menu as a document that would inform the customer of the nature of the conservation and load management options that were available. We presumed that the items of the menu would be described in fairly general terms, just as many of the conservation and load management programs in the utility's general rate case filing are described in general terms. We imagined that specific examples of how a general program had been fitted to a particular customer's needs would be presented to fill out the customer's understanding of its options. For example, in the most recent general rate case, that of Edison, a major nonresidential conservation program was described as the "Energy Management Incentive Program." The menu items would presumably be these sorts of general items, supplemented with information such as demand curves illustrating the effect of the program and examples of how customers had used these incentives, so that the special contract customer would have a better idea of how it could make use of this program. To use the example of the program mentioned above, a special contracts customer could select a rebate for conservation hardware not specifically mentioned in the examples of the menu but still fall within the menu's listed programs.

The menu was not intended to be as rigid as some parties have apparently viewed it. First, as we have just discussed, many of the current utility programs are defined very generally, with considerable latitude for fitting the program to a particular customer's needs. Second, beyond the utilities' current programs,

the decision allowed utilities to propose additions to the menu at the workshop of June 2, presumably programs other than those approved in their general rate cases.

More important, the decision repeatedly stated that contracts not conforming to the guidelines could nevertheless be approved after review in the EAD. If a particular customer negotiated a conservation item that varied substantially from the programs and illustrations of the menu, the contract could still be approved after the speedy review that is the purpose of the EAD.

One question that was not addressed in the decision was how new programs could be added to the menu. Any program approved in a utility's general rate case would qualify for the menu, so new programs may be added at that time. Between general rate cases, if a utility believes that a particular program varies substantially from the menu's programs and that other special contracts customers would likely be interested in similar programs, it may request, as a part of its EAD application for approval of the contract, that the Commission approve the conservation item for inclusion on the menu. The program will be subjected to appropriate cost-effectiveness tests as part of the EAD review, and if necessary this aspect of the application may be separated from the approval of the contract.

We continue to view the conservation menu as an outgrowth of the utility's existing conservation and load management programs. Accordingly, we agree with DRA's point that for anti-bypass contracts the effectiveness of individual conservation elements should be judged by the TRC test applied to other conservation and load management programs. For DSM options provided under an incremental sales agreement, the Ratepayer Impact Measure (RIM) test should usually be applied. This is because the TRC test can not be applied where the alternative is current electricity consumption versus increased electricity consumption.

The parties have provided several new proposals on the sources for financing the conservation options. After considering these proposals and their implications, we are persuaded to change the funding mechanism adopted in D.88-03-008.

We are particularly attracted to NRDC's appeal to create a symmetry between the treatment of the financing of rate discounts and conservation items. As NRDC points out, once the forecast is set, rate discounts beyond those forecasted are financed by shareholders as part of the utility's strategy for maximizing net revenues; the utility should be willing to accept a lower rate and lesser revenues from a customer, as a means of forestalling the zero revenue that would result if the customer leaves the system. The conservation incentives expected to be used for the cost-effective retention of customers should also be part of the revenue forecast. If conservation may also be used to retain a customer, the utility should likewise be willing to finance the conservation program that will keep the customer on the system. In each case, the net revenues to the utility are maximized. In each case, the utility has a strong incentive to provide the minimum amount of support needed to retain the customer.

We will finance conservation and load management items in the same way that we have previously established for financing rate discounts (by accounting for reduced sales to customers choosing the conservation options in the forecast of revenues for the LRC), and we will discuss some of the implications and details of this financing scheme in the following paragraphs.

In D.88-03-008, we limited the amount the utility could spend on the conservation items to "the present value of the total discount from tariff rates that the utility and the customer would agree to in the absence of the conservation option." That limit still seems appropriate, although the limit is probably superfluous, since a utility would be foolish to spend greater amounts on conservation than the value of the rate discounts that

would be sufficient to retain the customer. We should clarify, however, that in calculating the equivalent to the negotiated rate, the utility can and should take into account any lost contribution to margin and any administrative costs that it would incur in carrying out the conservation item. Our goal is to give the utility latitude in calculating the cost of the conservation items, so that it will be truly indifferent to the customer's choice.

In the past, if a utility was truly indifferent to conservation or rate discounts, we would have expected the utility to be inclined toward the rate discount, for a number of reasons. We would have expected this inclination to lead the utility to soft-pedal the conservation option, with the result that nearly all customers would choose the rate discount. Under present circumstances, however, we believe that the customer's preference will play a much greater role than in the past. The customer in these negotiations has considerable bargaining power; it has the option to leave the system unless the utility can provide a sufficient incentive to remain on the system. Because of the customer's strength in the bargaining, we believe that the customer's preference will overcome any minor incentives of the utility, and that conservation items will be chosen to the extent that customers prefer them to rate discounts.

Placing the responsibility for financing conservation items on the utility presents some questions about the function of our review in the EAD. If the customer chooses conservation items to the limit of the net present value of the rate discount, then the customer by definition will continue to take service at the tariff rate. If there is no rate discount, and if the utility is responsible for financing the conservation items, what is the need for the EAD review?

Although we agree with the implied point that the scope and purpose of our review are greatly reduced when no rate discounts are involved, we still believe that the utility should

seek and obtain our approval of its arrangements with the customer, even when those arrangements include only conservation items. If the items are all on the menu, the review will be perfunctory. However, all conservation items need examination for cost-effectiveness. Moreover, conservation and load management options need review to ensure that they have not crossed the line into load building. Even if DSM funding is being provided with shareholder funds, we still expect an application or EAD treatment to include cost-effectiveness analysis of the proposed project.

We expect a review of a contract containing only conservation items to be quick. The conservation and load management options present an easier review because we are less concerned about the harm to other ratepayers. One of the primary concerns about the special contracts program--that it would stimulate permanent additions to the the utility's load and thus accelerate the need for expensive new resources--is nearly absent for conservation and load management options. By definition, these programs reduce load, and even if the utility goes too far and overstimulates conservation and load management, the effect on other ratepayers will be negligible. The threat of long-term load effects is almost entirely absent.

For these reasons, we will require utilities to finance the conservation options in the same manner they finance rate discounts; the sales forecast for the LRC will recognize the effect on sales of customers choosing DSM options. The approach is justified on two bases. First, the utility will receive increased net revenues from retaining customers on the system; that is, the utility's net revenue should be greater, after accounting for the costs of discounts or conservation, than if the customer left the system. Second, the utility may receive increased net revenues in the near term because customers who choose conservation options will pay rates closer to the tariff rate than if the customer had selected only a rate discount. Until the conservation equipment or

process is completely installed and effective, the utility should receive slightly higher revenues than expected.

NRDC has proposed, in response to DRA's proposal, that the utility's responsibility to finance conservation options should begin after the utility has exhausted 25% of previously authorized conservation funds for nonresidential customers. We will not adopt this limitation. All conservation and load management options selected by customers eligible for special contracts should be financed by the utility, as outlined above.

The transition before final implementation of LRC sales forecasts leaves utilities without funding authorization for special DSM contracts. Furthermore, some special contracts customers who are eligible for existing and authorized conservation programs will seek DSM funding. Utilities should not discriminate against special contracts customers by barring them from these programs. The other side of this coin, however, is that we do not want other industrial or nonresidential customers to be foreclosed from taking advantage of authorized programs; special contracts customers should not be permitted to monopolize these programs. Therefore, we believe that no more than about 25% of the budget for nonresidential or industrial conservation programs should be allocated to eligible special contracts customers at this time. If additional funding is needed before adoption of the LRC sales forecast, utilities should obtain such authorization by advice letter filing.

The question whether to apply the conservation guideline to contracts for incremental sales is clouded by our expectation that two types of customers may take advantage of contracts for incremental sales. Some customers will merely choose to increase production from existing plant and equipment solely because of the lower marginal energy costs made possible by the contract. Since the increased production is truly incremental in these cases, any increased consumption of electricity will disappear when the

contract expires and the customer must return to higher tariff rates. But for other customers, the prospect of even a short-term reduction of electricity costs may tilt a close decision in favor of adding new equipment or expanding capacity. The new consumption stimulated in these cases will continue after the expiration of the contract.

Two considerations persuade us that contracts for incremental sales should also be subject to the conservation guideline. When such sales are truly incremental, such as when a factory increases production from existing equipment solely because of the lower marginal cost of energy, it is unlikely that the customer will select conservation options. These contracts are also likely to be short term, so the net present value of the negotiated discount will be small, and the conservation options that could be financed within the limits of this small net present value are probably few. Second, some incremental sales will occur when the prospect of lower energy costs tilts a customer's decision to add new production capacity. These cases present one-time opportunities to install efficient equipment, and the long-term benefits to ratepayers of having more efficient equipment installed justify the costs of offering the conservation options to such customers. In addition, by requiring positive results under the RIM test for incremental sales contracts, ratepayers are ensured of increasing marginal revenues from DSM measures.

Thus, we conclude that contracts for incremental sales should also be subject to the conservation guideline.

Finally, we agree with DRA that when the conservation options involve incentive payments to customers, the utility should obtain a verification that the equipment intended to be financed by the payment has been installed. The verification requirement applying in existing or recent incentive programs should also be followed in these cases.

III. Base Rate Revenue Requirements

The joint petitioners request clarification of how base rate revenue requirements would be established to develop base rates for the less restricted class on the transition date. Earlier decisions have left this point uncertain.

The joint petitioners suggest that the retail jurisdictional base rate revenue requirements used to develop the revenue allocation between the less restricted class and other customer classes and to develop the less restricted class's base rates on an assumed transition date of January 1, 1989, should reflect the 1989 attrition rate adjustments for PG&E and Edison and the test year rates resulting from SDG&E's pending general rate case. DRA supports this aspect of the initial joint petition.

We agree that the decision should be modified to clarify this point in the manner suggested by the joint petitioners.

The joint petitioners also state their "understanding" that base rate levels for the less restricted class may change to reflect changes in the retail jurisdictional base rate revenue requirements, other than adjustments resulting from the attrition rate adjustment. For example, a transfer of recovery of revenue requirement from a Major Additions Adjustment Clause (MAAC) account to base rates could have this effect.

It is clear that a transfer of recovery of revenue requirements such as in the MAAC example would affect the base rates of the less restricted class. Rather than imagining the adjustments necessary to accomplish such a transfer, we will await a concrete example before we address the details. The joint petition does not request modification of D.88-03-008 on this point.

Findings of Fact

1. DRA filed a petition for modification of D.88-03-008 on April 7, 1988, requesting changes to the definition of the less restricted class and to the conservation guideline.

2. PG&E, SDG&E, and Edison filed a joint petition for modification on April 19, 1988, requesting a clarification of the procedure for setting base rates for the less restricted class.

3. NRDC responded to DRA's petition on April 27, 1988, and presented some proposed modifications to the conservation guideline.

4. DRA responded to the initial joint petition on May 4, 1988, and supported the joint petitioners' request.

5. Edison responded to DRA's petition on May 6, CEC responded to DRA's petition on May 17, and PG&E responded to DRA's petition on May 20, 1988.

6. Edison, PG&E, and SDG&E filed a second joint petition to modify D.88-03-008 on June 13, 1988. NRDC responded to the second joint petition on June 27, DRA filed its response on July 1, CEC filed on July 12, and DGS filed on July 14.

7. The workshop on conservation options called for in D.88-03-008 was held on June 2. A summary of the workshop was prepared by the moderator and mailed to all parties on July 8.

Conclusions of Law

1. D.88-03-008 should be modified to clarify that the less restricted class includes all customers with demands of 1,000 kW or greater.

2. The conservation options that the utilities may present to customers negotiating special contracts should be those meeting the TRC test (for anti-bypass contracts) or the RIM test (for incremental sales contracts) as described in the Standard Practice Manual for Economic Analysis of Demand Side-Management Programs.

3. We will finance conservation and load management items in the same way that we have previously established for financing rate

discounts (by accounting for reduced sales to customers choosing the conservation options in the forecast of revenues for the LRC).

4. Utilities should not deny eligible special contracts customers access to existing and authorized conservation and load management programs in the short term, before the LRC sales forecasts are adopted. Other nonresidential and industrial customers should not be prevented from taking advantage of all authorized conservation programs, and, as a general rule, no more than about 25% of existing nonresidential and industrial DSM funding should be allocated to special contracts customers.

5. Conservation options should also be presented to customers with contracts for incremental sales.

6. The items eligible for conservation funding should include conservation and load management programs, but not fuel switching or load building programs.

7. The retail jurisdictional base rate revenue requirement used to develop the revenue allocation between the less regulated class and other customer classes on January 1, 1989, should reflect the 1989 attrition rate adjustments for PG&E and Edison and the test year rates resulting from SDG&E's pending general rate case.

ORDER

Therefore, IT IS ORDERED that:

1. The paragraph beginning at the bottom of page 25 and continuing to page 26 and the first full paragraph on page 26 of Decision 88-03-008 are modified to read:

The items in the menu would be developed in a workshop. The items should come from new or existing conservation and load management programs that meet the Total Resource Cost (TRC) test as set forth in the Standard Practice Manual on Economic Analysis of Demand-Side Management Programs, except in the case where DSM measures are applied to incremental sales contracts; the Ratepayer Impact Measure

(RIM) test shall be applied in such situations. In addition, parties may also propose other programs for inclusion on the menu that also meet the TRC test. The TRC test takes a somewhat broader perspective than the rate impact measure test we have applied to other conservation programs. Use of the TRC test in these circumstances is appropriate for two reasons. First, the TRC test is better suited for addressing the problem pointed out by NRDC: that companies impose a much shorter pay-back period on conservation investments than the utility does when it invests in new generation. Allowing the utility to offer conservation programs based on the TRC test is a way of grafting the longer pay-back criterion used by the utility onto the private industry's shorter periods. Second, a strict adherence to the rate impact measure test for potential bypass customers is not appropriate under present circumstances when the greatest effect on rates would come if the customer leaves the system. The slight effect on rates of the TRC test is far preferable to the large potential effect on rates of the loss of such customers.

The source of funds for the utility's offered items will be the increased net revenues resulting from retaining customers who accept these options, as defined by the LRC sales forecast. To the extent that the special contracts customers may legitimately take advantage of existing conservation and load management programs for which we authorized funds in the general rate case, the utilities should not deny such customers access to the programs. However, in the interim other industrial or nonresidential customers should not be foreclosed from taking advantage of authorized programs; special contracts customers should not be permitted to monopolize these programs. As a general guideline that may not make sense for a particular program, we believe that no more than about 25% of the budget for a particular nonresidential or industrial conservation or load management program should be allocated to customers with special contracts.

2. The following paragraphs are inserted after the first full paragraph on page 27:

Our discussion of this guideline has focused on the anti-bypass type of special contract. Clearly, presenting conservation options to these customers is desirable. A more difficult question is whether this guideline should also apply to contracts for incremental sales. We are permitting discounted incremental sales in hopes of spreading some of the fixed costs of excess capacity over a larger sales base. Increased efficiency would tend to reduce these sales, and promoting efficiency among these customers would seem to work against our purpose in permitting incremental sales.

Two considerations persuade us that contracts for incremental sales should also be subject to this guideline. When such sales are truly incremental, such as when a factory increases production from existing equipment solely because of the lower marginal energy costs made possible by the contract, it is unlikely that the customer will select conservation options. These contracts are also likely to be short term, so the net present value will be small, and the conservation options that could be financed within the limits of this small net present value are probably few. Second, some incremental sales will occur when the prospect of lower energy costs tilts a customer's decision to add new production capacity. These cases present one-time opportunities to install efficient equipment, and the long-term benefits to ratepayers of having efficient equipment installed justify the costs of offering the conservation option to such customers.

Thus, we conclude that contracts for incremental sales should also be subject to this guideline.

3. The first sentence of the first full paragraph of page 31 is modified to read:

For the present time we will accept the utilities' proposed definitions of the less restricted class as including all customers with demands of 1,000 kW or greater.

4. The following paragraphs are added after the first paragraph on page 34:

VI. Setting Initial Base Rates

Because two of the three utilities affected by the transition date will be in the middle of a rate case cycle at the time of the transition, we need to determine how to establish the base rate revenue requirement that will be used to allocate revenues between the less restricted class and other customer classes and to develop base rates for the less restricted class on the transition date. We believe that a fair way to solve this transitional problem is to use the base rate revenue requirement that will take effect on January 1, 1989. For SDG&E, the retail jurisdictional base rate revenue requirement resulting from its Test Year 1989 general rate case should be used. Both Edison and PG&E should use the retail jurisdictional base rate revenue requirement resulting from their respective ARA proceedings for the 1989 attrition year.

5. The heading on page 34 should be changed to read:

VII. Risk Allocation

6. Finding of Fact 15 on page 48 is modified to read:

It is reasonable to require utilities to present customers with a menu of conservation options during negotiations for special contracts. The elements of the menu will be developed in a workshop to be held as soon as feasible. The programs included in the menu should be conservation and load management programs that meet the TRC test of cost-effectiveness. The customer may then choose a contract based entirely on rate discounts, a contract based entirely on conservation items with all electricity sold at tariff rates, or a contract based on a mixture of rate discounts and conservation items. However, the utility's cost of the conservation items plus the net present value of any discount from tariff rates may not exceed the net present value of the total discount from tariff rates that the utility and the customer would have agreed to in the absence of the conservation option. The

source of funds for the conservation items. We will finance conservation and load management items in the same way that we have previously established for financing rate discounts (by accounting for reduced sales to customers choosing the conservation options in the forecast of revenues for the LRC). To the extent that the special contracts customers are eligible for existing and authorized conservation and load management programs, the utility should not deny such customers access to the programs. However, the access of other customers to conservation and load management programs should not be foreclosed, and as a general rule no more than about 25% of the funds authorized for a particular nonresidential or industrial demand management program should be allocated to special contracts customers. If necessary in the interim, utilities can apply for additional DSM funds for special contracts customers by advice letter.

7. Conclusion of Law 16 is modified to read:
At present, the less restricted class should include all customers with demand of 1,000 kW or greater.
8. Conclusion of Law 20 should be added on page 49:
Allocation of revenue between the less restricted class and other customer classes and base rates for the less restricted class for service rendered on and after January 1, 1989, should be based on the retail jurisdictional base rate revenue requirements as of January 1, 1989, adopted in SDG&E's Test Year 1989 general rate case and Edison's and PG&E's attrition proceedings for the 1989 attrition year.
9. Ordering Paragraph 2 is modified to read:
At the present time, the Large Light and Power class referred to in D.87-05-071, which is more properly called the less restricted class, will include all customers of PG&E, Edison, and SDG&E with demands of 1,000 kW or greater.

10. Ordering Paragraph 4 on pages 50-51 is modified to read:

Utilities shall present customers with a menu of conservation options during negotiations for special contracts. The elements of the menu will be developed in a workshop to be held as soon as feasible. The programs included in the menu should be conservation and load management programs that meet the Total Resource Cost test of cost-effectiveness. The customer may then choose a contract based entirely on rate discounts, a contract based entirely on conservation items with all electricity sold at tariff rates, or a contract based on a mixture of rate discounts and conservation items. However the utility's cost of the conservation items plus the net present value of any discount from tariff rates may not exceed the net present value of the total discount from tariff rates that the utility and the customer would have agreed to in the absence of the conservation option. The source of funds for the conservation items will be the revenues defined in the LRC revenue forecast. To the extent that the special contracts customers are eligible for existing and authorized conservation and load management programs, the utility should not deny such customers access to the programs. However, the access of other customers to conservation and load management programs should not be foreclosed, and the utility should seek to keep about 75% of the funds authorized for a particular program available to nonresidential or industrial customers who do not qualify for special contracts. The utilities can obtain necessary DSM funds for special contracts customers by advice letter, in the interim.

11. Ordering Paragraph 6a is added on page 51:

Revenue allocation between the less restricted class and other customer classes and base rates for the less restricted class for service rendered on and after January 1, 1989, will be based on the retail jurisdictional base rate revenue requirements as of January 1, 1989, adopted in SDG&E's Test Year 1989 general rate case and Edison's and PG&E's attrition proceedings for the 1989 attrition year.

This order is effective today.

Dated July 22, 1988, at San Francisco, California.

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

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

Victor Weiss
Victor Weiss, Executive Director

Decision SS 07 058 JUL 22 1988**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking Proceeding on the
Commission's Own Motion to
Revise Electric Utility Rate-
making Mechanisms in Response
to Changing Conditions in the
Electric Industry.

I.86-10-001
(Filed October 1, 1986)

OPINION ON PETITIONS FOR MODIFICATION

Petitions for modification of Decision (D.) 88-03-008 have been filed by the Division of Ratepayer Advocates (DRA) on April 7, 1988, and jointly by Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Southern California Edison Company (Edison) on April 19, 1988. Natural Resources Defense Council (NRDC) responded to DRA's petition on April 27, 1988, and the response also contained proposals for modification of D.88-03-008. DRA responded to the utilities' joint petition on May 4, 1988. Edison, the California Energy Commission (CEC), and PG&E responded to DRA's petition on May 6, May 17, and May 20, 1988, respectively.

Edison, PG&E, and SDG&E filed a second joint petition to modify D.88-03-008 on June 13, 1988. NRDC responded to the second joint petition on June 27, and DRA filed its response on July 1. California Energy Commission (CEC) filed on July 12, and the Department of General Services (DGS) filed on July 14.

In a related development, the workshop on conservation options called for in D.88-03-008 was held on June 2. A summary of the workshop was prepared by the moderator and mailed to all parties on July 8.

The initial joint petition included a proposal to change the transition date specified in D.88-03-008 from September 1,

1988, to January 1, 1989. That aspect of the joint petition has been addressed in D.88-05-072.

We will separately discuss each issue raised in the petitions.

I. The Definition of the Less Restricted Class

In its petition, DRA suggests that the decision should be modified to clarify that sales to all customers with demands of over 1,000 kilowatt (KW) will no longer be subject to the Electric Revenue Adjustment Mechanism (ERAM) after the transition date, regardless of a particular customer's potential to bypass the utility's system. At the same time, however, DRA argues that one exception should be made to this rule. DRA believes that sales to agricultural customers with demands of over 1,000 kW should continue to be included in ERAM and should be excluded from the less restricted class. DRA states that our desire to treat large agricultural customers differently from other large customers was shown in D.87-04-028, in which we directed PG&E to transfer large agricultural customers from the E-20 tariff to agricultural tariffs.

We intended in D.88-03-008 to include all customers with demands of 1,000 kW or more in the less restricted class, and sales to these customers would no longer be covered by ERAM after the transition date. However, the discussion in D.88-03-008 focused on whether or not the class should include smaller customers. Our concluding sentences therefore spoke of limiting the class to customers of 1,000 kW or more. We will make minor modifications to clarify our intent.

Edison opposed DRA's proposal to remove large agricultural customers from the less restricted class. Edison's TOU-8 schedule is based entirely on consumption characteristics and not on what use is made of that consumption. Edison believes that the decision similarly defined the less restricted class in terms of consumption characteristics. Edison believes that it is consistent to treat all customers with large demands alike and to

include all customers with demands of 1,000 kW or more in the less restricted class.

PG&E's response states without elaboration its support for DRA's recommendation.

Our action in D.87-04-028 resulted from a reorganization of rate design that had unexpected consequences for some agricultural customers. Our shifting of PG&E's very large agricultural customers from the E-20 schedule was not intended to express an opinion that these customers should be treated differently from other large customers in all respects, and we have not taken similar steps for the other utilities. For the present, we believe that the less restricted class should be defined by the size of the customer's demand, and not by the use to which the customer puts the electricity it purchases. We will not adopt DRA's proposed exception.

II. Modifications to the Conservation Guideline

In D.88-03-008, we adopted a guideline that required utilities to offer customers with whom they were negotiating special contracts an option of choosing programs to improve the efficiency of the customers' use of electricity instead of the full rate discount the parties would otherwise negotiate. The notion was that potential bypassers were primarily concerned with overall energy costs, and those costs could be lowered by conservation and load management as well as by rate discounts. DRA, NRDC, and the second joint petition proposed modifications to the decision's treatment of this topic.

A. DRA's Proposals

First, DRA asserted that it was unnecessary to develop the conservation menu, the list of approved conservation programs, called for in the decision. All that was needed to demonstrate the effectiveness of a particular proposal was for the utility to

present the analysis specified in the Standard Practice Manual for Economic Evaluation of Demand-Side Management Programs, developed by the staffs of the Commission and the CEC. If a particular program passes the Total Resource Cost (TRC) test, then it should be approved. According to DRA, this procedure would assure that the efficiency options associated with special contracts would have the same economic footing as conservation programs approved in the utility's general rate case.

Second, DRA has several objections to the decision's provision that the conservation options for special contracts customers would be initially funded from "the utility's authorized conservation budget for programs designed to serve" the less restricted class (D.88-03-008, Conclusion of Law 15, mimeo., p. 48). DRA points out that the currently authorized programs are given designations no more specific than "nonresidential" or "industrial" and that it is impossible to determine which programs are designed to serve the less restricted class.

DRA's proposal for modification has five elements. First, DRA suggests that the use of authorized conservation funds should be subject to existing restrictions on the utility's discretionary movement of conservation funds. Second, funds for conservation options associated with special contracts customers should be limited to 25% of the authorization for nonresidential programs. Third, any request for additional funds should be by an application, not by an advice letter, as permitted by the decision. Such an increase should receive a more thorough scrutiny than advice letter filings ordinarily receive. Fourth, customers should be required to verify that any conservation or load management equipment financed by the utility has, in fact, been installed. And fifth, the chance to choose conservation options instead of discounted rates should not be available for customers with contracts for incremental sales.

B. NRDC's Proposals

NRDC reacted to DRA's proposals and offered its own modification.

NRDC is disturbed by the lack of symmetry between the treatment of conservation options and rate discounts associated with special contracts. No limit has been proposed or imposed on the amount of the rate discounts that may be offered to customers threatening bypass, yet DRA has proposed a limit on the amount of the related conservation programs. NRDC believes that this asymmetry arises from a discomfort with the source of the funds for the two parts of the special contracts program. Once the forecast of revenues is established, rate discounts are financed by the shareholders, presumably in hopes of maximizing net revenues. Conservation options, on the other hand, are financed by ratepayers, resulting in the perception that a limit is needed.

NRDC proposes a funding arrangement that would lessen this asymmetry. Any conservation payments greater than the 25% limit proposed by DRA would be funded from "the increased net revenues generated by conservation-based special contracts." Since the conservation payment is limited to the net present value of the foregone rate discount, and since both conservation programs beyond the 25% limit and rate discounts would be financed by the utility's increased net revenues, the utility should continue to be indifferent about the customer's choice of rate discounts or conservation options.

NRDC also argues that reliance on the TRC test is unnecessary. The only test for a conservation option related to a special contract, in NRDC's view, should be whether the cost of the conservation program is less than the cost of the rate discount that the utility and the customer would otherwise agree to. NRDC asks, "Would DRA really want utilities to reject a \$200,000 conservation payment on the basis of DRA's cost-effectiveness yardstick, when the alternative was a \$300,000 rate discount?"

Finally, NRDC opposes DRA's suggestion that the

conservation guideline should not apply to contracts for incremental sales. NRDC believes that the decision is unambiguous and makes both anti-bypass and incremental sales special contracts subject to the conservation guideline. According to NRDC, the reasons for applying the guideline to anti-bypass special contracts apply with equal strength to contracts for incremental sales.

C. Edison's Position

Edison agrees with DRA that cost-effectiveness, and not whether a particular program is listed on the conservation menu, should be the test of the conservation and efficiency offerings a utility may make available to special contracts customers. Edison believes that a menu may quickly become outdated, and that the use of the term "conservation menu" neglects the important role that efficiency improvements play in retaining customers on the system.

Edison disagrees with the implication that the TRC test should be the primary test for determining which programs should be offered to special contracts customers. Edison believes that the TRC test cannot be used easily to test the efficiency of programs that increase electricity consumption, and Edison therefore recommends that programs that meet either the TRC test or the ratepayer impact measure should qualify.

Edison disagrees with the 25% limit proposed by DRA and recommends that funding requests for conservation options should be considered with each special contract. Since the Commission must eventually approve the contract through the Expedited Application Docket, it would be a simple matter to broaden this proceeding slightly to consider the request for the funding necessary to carry out the conservation options selected by the customer.

Edison agrees with DRA that customers who receive conservation incentive payments should have to verify that they have installed the equipment that the payment was intended to help finance.

Finally, Edison disagrees with DRA's proposal not to permit utilities to offer conservation options to customers with contracts for incremental sales. Edison believes that such payments may, in many instances, further the goals that the Commission has tried to pursue in this proceeding.

D. CEC's Position

CEC supports DRA's proposal for limiting the amount of authorized conservation funds that may be directed to special contracts customers as an interim solution to the question of how to finance the costs of conservation options provided to special contracts customers. CEC believes that this question should be addressed in more detail at the conservation workshop that was scheduled for June 2, 1988.

CEC opposes DRA's recommendation to drop the conservation menu approach in favor of case-by-case cost effectiveness testing. CEC suggests that the conservation menu should consist of programs that would be deemed "automatically cost-effective," and that only conservation options not on the menu would require individual cost-effectiveness test results. This approach would give many customers easy and inexpensive access to the programs on the list while allowing for new, innovative, or unique options to be pursued.

Finally, CEC urges the Commission not to decide the question whether conservation options should be made available to customers with contracts for incremental sales until it has received more complete information on the policy considerations and consequences of the decision. CEC believes that a workshop should be scheduled to consider this issue.

E. PG&E's Position

PG&E first urges expanding the concept of the conservation option to include all types of demand management programs, including load management options. A broader range of programs will improve PG&E's ability to tailor its conservation

options to fit a particular customer's needs, and many load management programs are already available.

PG&E agrees with DRA that it is not practical to develop a generic menu of options, but PG&E joins NRDC in questioning the need for any cost-effectiveness tests for efficiency programs for special contracts customers. A special contract with a rate discount, PG&E argues, may be viewed as a conservation program with zero benefit, since the customer's consumption and load curve are unaffected. Why then, PG&E asks, should the conservation options, which result in consumption or load-shaping benefits and which are conceived as a substitute for rate discounts, be subject to a stricter test of cost-effectiveness?

Like other parties, PG&E opposes DRA's suggestion that conservation options should not be made available to customers with contracts for incremental sales.

On the question of financing the conservation options, PG&E asserts that the ERAM classes receive the benefit of retained or enhanced sales and should therefore provide the financing for the conservation options chosen by special contracts customers. PG&E thus opposes both DRA's and NRDC's proposals on financing the conservation options. PG&E also opposes DRA's suggestion that additional funding for conservation for special contracts customers should be requested by advice letter.

F. The Second Joint Petition

The joint petitioners assert that the decision should be modified to correct an inappropriate limitation on the programs that are referred to in the conservation menu. Some parties at the conservation workshop of June 2 read the decision to limit the menu to standard conservation items; that is, measures that serve to reduce a customer's kilowatt-hour consumption. The joint petitioners believe, however, that in keeping with the purpose of this proceeding, a wider range of cost-effective efficiency options would be more useful in discouraging uneconomic bypass and in

retaining large customers on the utility's system.

More specifically, the joint petitioners urge the Commission to expand the conservation menu to include four broad categories of energy efficiency options. These categories are conservation, load management, fuel substitution, and load building, and appropriate definitions are stated in Appendix A of the "Demand-Side Management Reporting Requirements Manual," developed by the Commission's staff.

NRDC opposed the utilities' proposal to include load building as part of the menu of conservation options. NRDC points out that D.88-03-008 showed the Commission's continuing concern about the long-term effects of the special contracts program. This concern is demonstrated by the determination that "the term of a special contract should not extend into any year when forecasts indicate that additional capacity will be needed to meet target reserve margins." NRDC argues that load-building programs are much harder to limit. The increased loads that result from any load-building program are likely to remain on the system when expensive new capacity is needed, and the eventual costs to the system and its ratepayers could outweigh any near-term gains.

DRA advanced similar arguments in opposing the utilities' proposal to include fuel switching and load building as conservation options. DRA also argues that this part of the second joint petition is premature and should be addressed in evidentiary hearings.

G. Discussion

Our conception in developing the conservation menu approach to future flexibility was to try to serve several goals at once. Some of the utility's existing or newly developed conservation and load management programs would be offered to a targeted group of customers who, if they accepted the offers, would consume electricity more efficiently and would remain on the

utility's system and pay rates higher than the fully discounted rates they would have otherwise negotiated with the utility. The conservation programs would not only meet the Commission's standards of effectiveness, but they would also withstand the customer's direct economic comparison with rate discounts. Although we referred to a conservation menu, we used "conservation" as an abbreviation for conservation and load management programs. Our intent was to serve the utility's interest by maximizing net revenue from the customer, to meet the customer's needs by lowering its total power bill, and minimize system generation costs, to serve ratepayers' interests by retaining on the system a customer who would otherwise be lost. ✓

In terms of the clarification requested in the second joint petition, the programs referred to in the conservation menu should qualify as conservation or load management programs. We agree that the definitions stated in Appendix A of the "Demand-Side Management Reporting Requirements Manual" developed by our staff, with slight modifications to reflect this proceeding's focus on electricity, are appropriate:

"Conservation programs are defined as programs which have the effect of reducing consumption of electricity during most or many hours of operation of the equipment or building affected by the measure.

"Load management programs are defined as any program which reduces electric peak demand or has the primary effect of shifting electric demand from the hours of peak demand to nonpeak time periods."

We do not agree that fuel substitution and load building programs should be included in the options presented as part of the conservation menu. Fuel substitution frequently presents difficult problems of cross-subsidization or cost-allocation between electric and gas ratepayers or questions of whether or not overall efficiency is furthered.

Similarly, as DRA and NRDC point out, load building seems to conflict with some of the goals of this proceeding. Obviously, by permitting the utilities to stimulate incremental sales by offering reduced rates, we have tolerated some short-term load building. As we clarified in the recent Edison general rate case (D.87-12-066, pp. 141-143), load retention, which is classified in the Appendix A definitions as load building, is an appropriate application of DSM funds. But in the present circumstances, our tolerance of load building goes no further. We can see no advantage to long-term load building, and we have limited the terms of incremental sales contracts to guard against the harms that incremental sales could otherwise inflict on the utility's system and its ratepayers. We also believe that under current circumstances it is inappropriate for the utilities to expend funds to encourage load building.

For purposes of defining eligible DSM alternatives (conservation and load-management) to a rate discount, we believe it appropriate to exclude fuel substitution and load building at this time. This is entirely consistent with the goals of this proceeding. Thus, for eligibility purposes, DSM alternatives should be compared to current consumption.

The analysis for cost-effectiveness of DSM, however, presents separate considerations. Different alternatives to bypass involve different costs and benefits which accordingly deserve appropriate treatment. Specifically, all conservation and load-management measures, when installed in lieu of bypass, must be evaluated against the proposed bypass technology. This will usually require a "fuel substitution" type of analysis (e.g., electric service with a DSM incentive compared to gas cogeneration). This type of analysis is explained clearly in the Joint Standard Practice Manual.

The report of the conservation workshop indicates that many parties were confused about other aspects of the conservation

menu. In particular, parties appear to have debated whether the menu was intended to be fixed or flexible and whether the menu was a necessary or even desirable feature of the conservation guideline. We do not believe that our original conception was as confusing as the parties have interpreted it to be, or that our statements about the conservation guideline were as unclear as the parties have found them. Nevertheless, it appears that this proceeding will benefit from further explanation of our conception of the purpose and function of the conservation menu.

This part of the proceeding arose out of our concern about a growing number of customers who were bypassing the utility's system by developing self-generation capabilities. We determined that we could serve the twin goals of combatting bypass and making use of the utility's short-term excess capacity by permitting the utility to enter into contracts to sell electricity at less than the tariff rate to customers who could present a credible threat of bypassing the system. To comply with statutory requirements and to ensure that other ratepayers were not unreasonably harmed by these special contracts, we established a review process, the Expedited Application Docket (EAD), to allow quick approval of these contracts. To further speed up the review process of the less controversial contracts, we adopted a series of guidelines.

At the same time, however, we were concerned that the additional sales stipulated by these lower rates could accelerate the time when the utility would need to add capacity to meet its target reserve margin. The conservation guideline was an attempt to lessen this problem.

The conservation menu is an aspect of the guideline. It serves two interrelated functions. First, it provides the utility with a convenient way of initiating discussions with the customer about conservation and load management options. Second, it gives the utility a ready method of demonstrating that it has complied

with the requirements of the conservation guideline, that it has offered certain conservation and load management programs to the customer in place of the negotiated rate discount.

Thus, we conceived of the menu as a document that would inform the customer of the nature of the conservation and load management options that were available. We presumed that the items of the menu would be described in fairly general terms, just as many of the conservation and load management programs in the utility's general rate case filing are described in general terms. We imagined that specific examples of how a general program had been fitted to a particular customer's needs would be presented to fill out the customer's understanding of its options. For example, in the most recent general rate case, that of Edison, a major nonresidential conservation program was described as the "Energy Management Incentive Program." The menu items would presumably be these sorts of general items, supplemented with information such as demand curves illustrating the effect of the program and examples of how customers had used these incentives, so that the special contract customer would have a better idea of how it could make use of this program. To use the example of the program mentioned above, a special contracts customer could select a rebate for conservation hardware not specifically mentioned in the examples of the menu but still fall within the menu's listed programs. ✓✓

The menu was not intended to be as rigid as some parties have apparently viewed it. First, as we have just discussed, many of the current utility programs are defined very generally, with considerable latitude for fitting the program to a particular customer's needs. Second, beyond the utilities' current programs, the decision allowed utilities to propose additions to the menu at the workshop of June 2, presumably programs other than those approved in their general rate cases.

More important, the decision repeatedly stated that contracts not conforming to the guidelines could nevertheless be

approved after review in the EAD. If a particular customer negotiated a conservation item that varied substantially from the programs and illustrations of the menu, the contract could still be approved after the speedy review that is the purpose of the EAD.

One question that was not addressed in the decision was how new programs could be added to the menu. Any program approved in a utility's general rate case would qualify for the menu, so new programs may be added at that time. Between general rate cases, if a utility believes that a particular program varies substantially from the menu's programs and that other special contracts customers would likely be interested in similar programs, it may request, as a part of its EAD application for approval of the contract, that the Commission approve the conservation item for inclusion on the menu. The program will be subjected to appropriate cost-effectiveness tests as part of the EAD review, and if necessary this aspect of the application may be separated from the approval of the contract.

We continue to view the conservation menu as an outgrowth of the utility's existing conservation and load management programs. Accordingly, we agree with DRA's point that for anti-bypass contracts the effectiveness of individual conservation elements should be judged by the TRC test applied to other conservation and load management programs. For DSM options provided under an incremental sales agreement, the Ratepayer Impact Measure (RIM) test should usually be applied. This is because the TRC test can not be applied where the alternative is current electricity consumption versus increased electricity consumption.

The parties have provided several new proposals on the sources for financing the conservation options. After considering these proposals and their implications, we are persuaded to change the funding mechanism adopted in D.88-03-008.

We are particularly attracted to NRDC's appeal to create a symmetry between the treatment of the financing of rate discounts

and conservation items. As NRDC points out, once the forecast is set, rate discounts beyond those forecasted are financed by shareholders as part of the utility's strategy for maximizing net revenues; the utility should be willing to accept a lower rate and lesser revenues from a customer, as a means of forestalling the zero revenue that would result if the customer leaves the system. The conservation incentives expected to be used for the cost-effective retention of customers should also be part of the revenue forecast. If conservation may also be used to retain a customer, the utility should likewise be willing to finance the conservation program that will keep the customer on the system. In each case, the net revenues to the utility are maximized. In each case, the utility has a strong incentive to provide the minimum amount of support needed to retain the customer.

We will finance conservation and load management items in the same way that we have previously established for financing rate discounts (by accounting for reduced sales to customers choosing the conservation options in the forecast of revenues for the LRC), and we will discuss some of the implications and details of this financing scheme in the following paragraphs.

In D.88-03-008, we limited the amount the utility could spend on the conservation items to "the present value of the total discount from tariff rates that the utility and the customer would agree to in the absence of the conservation option." That limit still seems appropriate, although the limit is probably superfluous, since a utility would be foolish to spend greater amounts on conservation than the value of the rate discounts that would be sufficient to retain the customer. We should clarify, however, that in calculating the equivalent to the negotiated rate, ✓ the utility can and should take into account any lost contribution to margin and any administrative costs that it would incur in carrying out the conservation item. Our goal is to give the utility latitude in calculating the cost of the conservation items,

so that it will be truly indifferent to the customer's choice.

In the past, if a utility was truly indifferent to conservation or rate discounts, we would have expected the utility to be inclined toward the rate discount, for a number of reasons. We would have expected this inclination to lead the utility to soft-pedal the conservation option, with the result that nearly all customers would choose the rate discount. Under present circumstances, however, we believe that the customer's preference will play a much greater role than in the past. The customer in these negotiations has considerable bargaining power; it has the option to leave the system unless the utility can provide a sufficient incentive to remain on the system. Because of the customer's strength in the bargaining, we believe that the customer's preference will overcome any minor incentives of the utility, and that conservation items will be chosen to the extent that customers prefer them to rate discounts.

Placing the responsibility for financing conservation items on the utility presents some questions about the function of our review in the EAD. If the customer chooses conservation items to the limit of the net present value of the rate discount, then the customer by definition will continue to take service at the tariff rate. If there is no rate discount, and if the utility is responsible for financing the conservation items, what is the need for the EAD review?

Although we agree with the implied point that the scope and purpose of our review are greatly reduced when no rate discounts are involved, we still believe that the utility should seek and obtain our approval of its arrangements with the customer, even when those arrangements include only conservation items. If the items are all on the menu, the review will be perfunctory. However, all conservation items need examination for cost-effectiveness. Moreover, conservation and load management options

need review to ensure that they have not crossed the line into load building. Even if DSM funding is being provided with shareholder funds, we still expect an application or EAD treatment to include cost-effectiveness analysis of the proposed project.

We expect a review of a contract containing only conservation items to be quick. The conservation and load management options present an easier review because we are less concerned about the harm to other ratepayers. One of the primary concerns about the special contracts program--that it would stimulate permanent additions to the utility's load and thus accelerate the need for expensive new resources--is nearly absent for conservation and load management options. By definition, these programs reduce load, and even if the utility goes too far and overstimulates conservation and load management, the effect on other ratepayers will be negligible. The threat of long-term load effects is almost entirely absent.

For these reasons, we will require utilities to finance the conservation options in the same manner they finance rate discounts; the sales forecast for the LRC will recognize the effect on sales of customers choosing DSM options. The approach is justified on two bases. First, the utility will receive increased net revenues from retaining customers on the system; that is, the utility's net revenue should be greater, after accounting for the costs of discounts or conservation, than if the customer left the system. Second, the utility may receive increased net revenues in the near term because customers who choose conservation options will pay rates closer to the tariff rate than if the customer had selected only a rate discount. Until the conservation equipment or process is completely installed and effective, the utility should receive slightly higher revenues than expected.

NRDC has proposed, in response to DRA's proposal, that the utility's responsibility to finance conservation options should begin after the utility has exhausted 25% of previously authorized

conservation funds for nonresidential customers. We will not adopt this limitation. All conservation and load management options selected by customers eligible for special contracts should be financed by the utility, as outlined above.

The transition before final implementation of LRC sales forecasts leaves utilities without funding authorization for special DSM contracts. Furthermore, some special contracts customers who are eligible for existing and authorized conservation programs will seek DSM funding. Utilities should not discriminate against special contracts customers by barring them from these programs. The other side of this coin, however, is that we do not want other industrial or nonresidential customers to be foreclosed from taking advantage of authorized programs; special contracts customers should not be permitted to monopolize these programs. Therefore, we believe that no more than about 25% of the budget for nonresidential or industrial conservation programs should be allocated to eligible special contracts customers at this time. If additional funding is needed before adoption of the LRC sales forecast, utilities should obtain such authorization by advice letter filing. ✓

The question whether to apply the conservation guideline to contracts for incremental sales is clouded by our expectation that two types of customers may take advantage of contracts for incremental sales. Some customers will merely choose to increase production from existing plant and equipment solely because of the lower marginal energy costs made possible by the contract. Since the increased production is truly incremental in these cases, any increased consumption of electricity will disappear when the contract expires and the customer must return to higher tariff rates. But for other customers, the prospect of even a short-term reduction of electricity costs may tilt a close decision in favor of adding new equipment or expanding capacity. The new consumption stimulated in these cases will continue after the expiration of the

contract.

Two considerations persuade us that contracts for incremental sales should also be subject to the conservation guideline. When such sales are truly incremental, such as when a factory increases production from existing equipment solely because of the lower marginal cost of energy, it is unlikely that the customer will select conservation options. These contracts are also likely to be short term, so the net present value of the negotiated discount will be small, and the conservation options that could be financed within the limits of this small net present value are probably few. Second, some incremental sales will occur when the prospect of lower energy costs tilts a customer's decision to add new production capacity. These cases present one-time opportunities to install efficient equipment, and the long-term benefits to ratepayers of having more efficient equipment installed justify the costs of offering the conservation options to such customers. In addition, by requiring positive results under the RIM test for incremental sales contracts, ratepayers are ensured of increasing marginal revenues from DSM measures.

Thus, we conclude that contracts for incremental sales should also be subject to the conservation guideline.

Finally, we agree with DRA that when the conservation options involve incentive payments to customers, the utility should obtain a verification that the equipment intended to be financed by the payment has been installed. The verification requirement applying in existing or recent incentive programs should also be followed in these cases.

III. Base Rate Revenue Requirements

The joint petitioners request clarification of how base rate revenue requirements would be established to develop base

rates for the less restricted class on the transition date. Earlier decisions have left this point uncertain.

The joint petitioners suggest that the retail jurisdictional base rate revenue requirements used to develop the revenue allocation between the less restricted class and other customer classes and to develop the less restricted class's base rates on an assumed transition date of January 1, 1989, should reflect the 1989 attrition rate adjustments for PG&E and Edison and the test year rates resulting from SDG&E's pending general rate case. DRA supports this aspect of the initial joint petition.

We agree that the decision should be modified to clarify this point in the manner suggested by the joint petitioners.

The joint petitioners also state their "understanding" that base rate levels for the less restricted class may change to reflect changes in the retail jurisdictional base rate revenue requirements, other than adjustments resulting from the attrition rate adjustment. For example, a transfer of recovery of revenue requirement from a Major Additions Adjustment Clause (MAAC) account to base rates could have this effect.

It is clear that a transfer of recovery of revenue requirements such as in the MAAC example would affect the base rates of the less restricted class. Rather than imagining the adjustments necessary to accomplish such a transfer, we will await a concrete example before we address the details. The joint petition does not request modification of D.88-03-008 on this point.

Findings of Fact

1. DRA filed a petition for modification of D.88-03-008 on April 7, 1988, requesting changes to the definition of the less restricted class and to the conservation guideline.

2. PG&E, SDG&E, and Edison filed a joint petition for modification on April 19, 1988, requesting a clarification of the procedure for setting base rates for the less restricted class.

3. NRDC responded to DRA's petition on April 27, 1988, and presented some proposed modifications to the conservation guideline.

4. DRA responded to the initial joint petition on May 4, 1988, and supported the joint petitioners' request.

5. Edison responded to DRA's petition on May 8, CEC responded to DRA's petition on May 17, and PG&E responded to DRA's petition on May 20, 1988.

6. Edison, PG&E, and SDG&E filed a second joint petition to modify D.88-03-008 on June 13, 1988. NRDC responded to the second joint petition on June 27, DRA filed its response on July 1, CEC filed on July 12, and DGS filed on July 14.

7. The workshop on conservation options called for in D.88-03-008 was held on June 2. A summary of the workshop was prepared by the moderator and mailed to all parties on July 8.

Conclusions of Law

1. D.88-03-008 should be modified to clarify that the less restricted class includes all customers with demands of 1,000 kW or greater.

2. The conservation options that the utilities may present to customers negotiating special contracts should be those meeting the TRC test (for anti-bypass contracts) or the RIM test (for incremental sales contracts) as described in the Standard Practice Manual for Economic Analysis of Demand Side-Management Programs.

3. We will finance conservation and load management items in the same way that we have previously established for financing rate discounts (by accounting for reduced sales to customers choosing the conservation options in the forecast of revenues for the LRC).

4. Utilities should not deny eligible special contracts customers access to existing and authorized conservation and load management programs in the short term, before the LRC sales forecasts are adopted. Other nonresidential and industrial

customers should not be prevented from taking advantage of all authorized conservation programs, and, as a general rule, no more than about 25% of existing nonresidential and industrial DSM funding should be allocated to special contracts customers.

5. Conservation options should also be presented to customers with contracts for incremental sales.

6. The items eligible for conservation funding should include conservation and load management programs, but not fuel switching or load building programs. ✓

7. The retail jurisdictional base rate revenue requirement used to develop the revenue allocation between the less regulated class and other customer classes on January 1, 1989, should reflect the 1989 attrition rate adjustments for PG&E and Edison and the test year rates resulting from SDG&E's pending general rate case.

ORDER

Therefore, IT IS ORDERED that:

1. The paragraph beginning at the bottom of page 25 and continuing to page 26 and the first full paragraph on page 26 of Decision 88-03-008 are modified to read:

The items in the menu would be developed in a workshop. The items should come from new or existing conservation and load management programs that meet the Total Resource Cost (TRC) test as set forth in the Standard Practice Manual on Economic Analysis of Demand-Side Management Programs, except in the case where DSM measures are applied to incremental sales contracts; the Ratepayer Impact Measure (RIM) test shall be applied in such situations. In addition, parties may also propose other programs for inclusion on the menu that also meet the TRC test. The TRC test takes a somewhat broader perspective than the rate impact measure test we have applied to other conservation programs. Use of the TRC test in these circumstances is appropriate for two reasons. First, the TRC test is better suited

for addressing the problem pointed out by NRDC: that companies impose a much shorter pay-back period on conservation investments than the utility does when it invests in new generation. Allowing the utility to offer conservation programs based on the TRC test is a way of grafting the longer pay-back criterion used by the utility onto the private industry's shorter periods. Second, a strict adherence to the rate impact measure test for potential bypass customers is not appropriate under present circumstances when the greatest effect on rates would come if the customer leaves the system. The slight effect on rates of the TRC test is far preferable to the large potential effect on rates of the loss of such customers. ✓

The source of funds for the utility's offered items will be the increased net revenues resulting from retaining customers who accept these options, as defined by the LRC sales forecast. To the extent that the special contracts customers may legitimately take advantage of existing conservation and load management programs for which we authorized funds in the general rate case, the utilities should not deny such customers access to the programs. However, in the interim other industrial or nonresidential customers should not be foreclosed from taking advantage of authorized programs; special contracts customers should not be permitted to monopolize these programs. As a general guideline that may not make sense for a particular program, we believe that no more than about 25% of the budget for a particular nonresidential or industrial conservation or load management program should be allocated to customers with special contracts. ✓

2. The following paragraphs are inserted after the first full paragraph on page 27:

Our discussion of this guideline has focused on the anti-bypass type of special contract. Clearly, presenting conservation options to these customers is desirable. A more difficult question is whether this guideline should also apply to contracts for incremental sales. We are permitting discounted incremental sales in

hopes of spreading some of the fixed costs of excess capacity over a larger sales base. Increased efficiency would tend to reduce these sales, and promoting efficiency among these customers would seem to work against our purpose in permitting incremental sales.

Two considerations persuade us that contracts for incremental sales should also be subject to this guideline. When such sales are truly incremental, such as when a factory increases production from existing equipment solely because of the lower marginal energy costs made possible by the contract, it is unlikely that the customer will select conservation options. These contracts are also likely to be short term, so the net present value will be small, and the conservation options that could be financed within the limits of this small net present value are probably few. Second, some incremental sales will occur when the prospect of lower energy costs tilts a customer's decision to add new production capacity. These cases present one-time opportunities to install efficient equipment, and the long-term benefits to ratepayers of having efficient equipment installed justify the costs of offering the conservation option to such customers.

Thus, we conclude that contracts for incremental sales should also be subject to this guideline.

3. The first sentence of the first full paragraph of page 31 is modified to read:

For the present time we will accept the utilities' proposed definitions of the less restricted class as including all customers with demands of 1,000 kW or greater.

4. The following paragraphs are added after the first paragraph on page 34:

VI. Setting Initial Base Rates

Because two of the three utilities affected by the transition date will be in the middle of a rate case cycle at the time of the transition, we need to determine how to establish the base

rate revenue requirement that will be used to allocate revenues between the less restricted class and other customer classes and to develop base rates for the less restricted class on the transition date. We believe that a fair way to solve this transitional problem is to use the base rate revenue requirement that will take effect on January 1, 1989. For SDG&E, the retail jurisdictional base rate revenue requirement resulting from its Test Year 1989 general rate case should be used. Both Edison and PG&E should use the retail jurisdictional base rate revenue requirement resulting from their respective ARA proceedings for the 1989 attrition year.

5. The heading on page 34 should be changed to read:

VII. Risk Allocation

6. Finding of Fact 15 on page 48 is modified to read:

It is reasonable to require utilities to present customers with a menu of conservation options during negotiations for special contracts. The elements of the menu will be developed in a workshop to be held as soon as feasible. The programs included in the menu should be conservation and load management programs that meet the TRC test of cost-effectiveness. The customer may then choose a contract based entirely on rate discounts, a contract based entirely on conservation items with all electricity sold at tariff rates, or a contract based on a mixture of rate discounts and conservation items. However, the utility's cost of the conservation items plus the net present value of any discount from tariff rates may not exceed the net present value of the total discount from tariff rates that the utility and the customer would have agreed to in the absence of the conservation option. The source of funds for the conservation items. We will finance conservation and load management items in the same way that we have previously established for financing rate discounts (by accounting for reduced sales to customers choosing the conservation options in the forecast of revenues for the LRC). To the extent that the special contracts customers are eligible for existing and authorized

conservation and load management programs, the utility should not deny such customers access to the programs. However, the access of other customers to conservation and load management programs should not be foreclosed, and as a general rule no more than about 25% of the funds authorized for a particular nonresidential or industrial demand management program should be allocated to special contracts customers. If necessary in the interim, utilities can apply for additional DSM funds for special contracts customers by advice letter.

7. Conclusion of Law 16 is modified to read:
At present, the less restricted class should include all customers with demand of 1,000 kW or greater.
8. Conclusion of Law 20 should be added on page 49:
Allocation of revenue between the less restricted class and other customer classes and base rates for the less restricted class for service rendered on and after January 1, 1989, should be based on the retail jurisdictional base rate revenue requirements as of January 1, 1989, adopted in SDG&E's Test Year 1989 general rate case and Edison's and PG&E's attrition proceedings for the 1989 attrition year.
9. Ordering Paragraph 2 is modified to read:
At the present time, the Large Light and Power class referred to in D.87-05-071, which is more properly called the less restricted class, will include all customers of PG&E, Edison, and SDG&E with demands of 1,000 kW or greater.

10. Ordering Paragraph 4 on pages 50-51 is modified to read:

Utilities shall present customers with a menu of conservation options during negotiations for special contracts. The elements of the menu will be developed in a workshop to be held as soon as feasible. The programs included in the menu should be conservation and load management programs that meet the Total Resource Cost test of cost-effectiveness. The customer may then choose a contract based entirely on rate discounts, a contract based entirely on conservation items with all electricity sold at tariff rates, or a contract based on a mixture of rate discounts and conservation items. However the utility's cost of the conservation items plus the net present value of any discount from tariff rates may not exceed the net present value of the total discount from tariff rates that the utility and the customer would have agreed to in the absence of the conservation option. The source of funds for the conservation items will be the revenues defined in the LRC revenue forecast. To the extent that the special contracts customers are eligible for existing and authorized conservation and load management programs, the utility should not deny such customers access to the programs. However, the access of other customers to conservation and load management programs should not be foreclosed, and the utility should seek to keep about 75% of the funds authorized for a particular program available to nonresidential or industrial customers who do not qualify for special contracts. The utilities can obtain necessary DSM funds for special contracts customers by advice letter, in the interim.

11. Ordering Paragraph 6a is added on page 51:

Revenue allocation between the less restricted class and other customer classes and base rates for the less restricted class for service rendered on and after January 1, 1989, will be based on the retail jurisdictional base rate revenue requirements as of January 1, 1989, adopted in SDG&E's Test Year 1989 general rate case and Edison's and PG&E's attrition proceedings for the 1989 attrition year.

This order is effective today.

Dated JUL 22 1988, at San Francisco, California.

STANLEY W. HULETT
President

DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners