

Decision 89 07 022

JUL 6 1989

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Mailed

Application of PACIFIC GAS AND)
 ELECTRIC COMPANY for authority,)
 among other things, to increase)
 its rates and charges for)
 electric and gas service.)

Application 82-12-48
 (Petition filed July 13, 1988)

JUL 7 1989

(Electric and Gas) U 39 M)

OPINIONI. Summary

This order addresses the petition of Southeast Energy, Inc. (Southeast) to modify Decision (D.) 83-12-068. Southeast asks the Commission to clarify what capacity payments it should receive if PG&E's Standard Offer 2 (SO2) remains suspended. Southeast is among those QFs that opted to receive capacity payments based on the capacity schedule in effect on its operation date. We find that Southeast, and similarly situated qualifying facilities (QFs), are entitled to fixed, levelized capacity payments over the term of their contract. However, these QFs are not entitled to the capacity schedule adopted in D.83-12-068, and extended by D.87-09-069. Absent a negotiated settlement, firm capacity prices for Southeast and similarly situated QFs will be developed in the Biennial Resource Plan Update Proceeding.

II. Background

Under Article 3 of PG&E's existing S02, a QF can elect one of two options for determining contract capacity prices.¹ Under the "execution date" option, capacity payments are based on the firm capacity price schedule in effect on the date of contract execution. Under the "future price schedule" option, capacity payments are based on the firm capacity price schedule in effect on the date of actual operations. The "actual operation date" is the date the facility demonstrates its ability to deliver firm capacity.

1 We make references to both Standard Offer 2 (S02) and Standard Offer 1 (S01) throughout this order. A brief description of their purposes and payment terms should prove useful to the unfamiliar reader:

By D.82-12-120, D.83-10-093, and D.84-03-092, we made S01 and S02 available to QFs for the purchase of "as-available" energy and capacity and "firm" capacity. S01 was designed for QFs that could only commit to deliveries on an as-available basis. S02 was designed for QFs that could commit firm capacity to the system and meet certain performance requirements.

Both S01 and S02 are "short-run" offers: The energy price is computed on the basis of the purchasing utility's existing generation resources, without consideration of possible resource additions. Energy prices under both offers are updated periodically and fluctuate over the term of the contract.

S01 capacity prices depend on short-term forecasts of the utility's loads and resources. Like the energy price, the S01 capacity price varies over the term of the contract.

In contrast, S02 capacity prices are based on long-term forecasts of the utility's loads and resources. They are fixed (and leveled) for the whole term of the contract (up to 30 years).

For those QFs that signed SO2 contracts in 1984-1986 and elected to be paid under the "execution date" option, firm levelized capacity prices were established in D.83-12-068, the decision in PG&E's Test Year 1984 general rate case. Table VI-4 of that decision covered contracts with on-line dates through 1988.² In D.87-09-025, the Commission extended the original firm capacity price schedule to cover the years 1989 to 1991. The extension was based on an extrapolation of the original prices established in 1983.

On March 19, 1986, the Commission issued D.86-03-069, which temporarily suspended the availability of SO2. By D.86-05-024, the Commission continued the suspension of SO2, to allow time to consider methods for updating QF capacity values.³ To date, the Commission has not reinstated SO2 for PG&E. The next time the Commission is scheduled to address SO2 reinstatement issues is during Phase 2 of the Biennial Resource Plan Update (BRPU) proceeding.⁴

2 Certain clerical errors in this table were corrected by the Commission in D.84-05-101.

3 Concerns prompting the suspension were that our SO2 updating and capacity valuation procedures appeared inadequate to reflect the utilities' varying needs for new capacity. (See D.86-05-024, pp. 15-17.) We have since made modifications meeting these concerns, and have reinstated SO2 for SDG&E for a limited solicitation of 182.4 megawatts (MW). (See D.86-11-071, D.87-11-024, and D.89-02-017.) However, in D.87-11-024, we decided not to reinstate SO2 for PG&E or SCE, due to the low need for new capacity on their systems.

4 See the Administrative Law Judge's (ALJ) Ruling, dated April 19, 1989, in Application (A.) 82-04-044 et al.

III. Position of the Parties

A. Southeast's Petition

Southeast plans to operate a 42 MW natural gas cogeneration facility in Bakersfield, California, and currently holds an executed SO2 contract with PG&E.⁵ At the time of contract signing, Southeast elected the future price schedule option for capacity payments. Under the terms of its contract, Southeast must commence actual operations by December 22, 1991.

On July 13, 1988, Southeast filed a petition to modify D.83-12-068, the decision in PG&E's test year 1984 general rate case. Southeast asks the Commission to specify the firm capacity prices it should receive if actual operations commence while SO2 is still suspended. Southeast does not propose a method for establishing these prices.

B. PG&E

On August 15, 1988, PG&E filed a protest to Southeast's petition. In its protest, PG&E identifies five alternative methods for developing SO2 capacity prices for Southeast and similarly situated QFs:⁶ (1) to pay zero for capacity until the Commission reinstates SO2, (2) to give Southeast the 1984 price schedule that it previously turned down, (3) to develop a new capacity price schedule for Southeast, (4) to permit individual negotiations, and

5 Southeast submitted a SO2 contract to PG&E prior to the Commission's suspension of SO2 on March 19, 1986. PG&E concurred with Southeast's subsequent claim of "orphan" status. See PG&E's Protest, page 2.

6 Seven other QFs also selected the future price schedule option under PG&E's SO2. However, according to PG&E, two are well down on the transmission capacity waiting list, and the others have had no recent project activity. See PG&E's Protest, page 3.

(5) to pay SO1 variable capacity prices until a capacity "need" threshold is reached.

PG&E urges the Commission to permit individual negotiations to proceed based on current capacity values and forecasts. If negotiations are not productive, PG&E recommends payment of variable, unlevelized SO1 capacity prices until reinstated SO2 prices become available. According to PG&E, any other alternative imposes either unjust costs on ratepayers, unnecessary penalties on Southeast, or unjustifiable burdens on the Commission.

C. DRA

DRA filed a response to Southeast's petition on August 15, 1988. In DRA's view, it is not necessary to modify D.83-12-068 to respond to Southeast's petition. Like PG&E, DRA asserts that QFs who elected the future price schedule option are not entitled to the original schedule established in D.83-12-068, as extended by D.87-09-025. Instead, DRA recommends that the Commission clarify that the firm capacity price schedule updated periodically during the BRPU proceeding is applicable to QFs such as Southeast.⁷

D. Southeast's Reply

On September 6, Southeast filed a reply. While it favors negotiations, Southeast argues that it has no bargaining power if its existing SO2 is essentially "without value," as implied by the interpretations advanced by PG&E and DRA. Southeast urges the Commission to determine whether QFs electing the future capacity price option were expected to take the risk that no prices would be in effect on the date of actual operation. This, in turn, would

⁷ DRA does not present a position on what to pay Southeast, if it becomes operational before we establish a firm capacity schedule.

determine whether or not there is any value to Southeast's SO2 contract.

IV. Discussion

The capacity schedule adopted in D.83-12-068, and extended by D.87-09-069, is our only adopted set of SO2 firm capacity prices through 1991 for PG&E. We agree with PG&E and DRA that they are not applicable to Southeast and similarly situated QFs. As we stated in D.87-09-025:

"We agree that any QF electing the latter date [of actual operations] is not entitled to a capacity price calculated from Table VI-4. Such a QF has expressly assumed the risk that the schedule in effect on its actual operation date could specify lower (or higher) capacity payments, depending on PG&E's current capacity needs, than would be derived by extrapolating from Table VI-4." (D.87-09-025, mimeo. page 6.)

What are the applicable capacity prices? Both PG&E and Southeast favor a negotiated resolution of this issue. We agree that negotiations should be allowed to proceed. However, we still need to clarify: (1) what capacity payments Southeast and similarly situated QFs are entitled to, and (2) how a capacity schedule will be developed, should negotiations prove unproductive. We agree with DRA that such clarifications will suffice in addressing Southeast's petition; modification of D.83-12-068 is not necessary.

Contrary to PG&E's assertions, Southeast and similarly situated QFs are entitled to fixed and levelized capacity payments over the term of their contract. These were the payment terms established for all SO2 contracts, prior to our suspension orders. Paying zero or SO1 variable prices for capacity would be tantamount

to suspending SO2 "retroactively" for these QFs.⁸ We have already ruled that the suspension of SO2 should be applied to prospective QFs only.⁹ Moreover, as we have stated in the past, observations concerning the current availability of SO2, or how capacity payments might be restructured for future SO2 offerings, cannot affect the validity of contracts signed before the suspension.¹⁰ We therefore reject the "zero payment" and "variable SO1 payment" options presented by PG&E for our consideration.

As we have described in prior orders, SO2 firm capacity prices should be based on current long-term forecasts of the utility's loads and resources.¹¹ We intend to update these forecasts for PG&E during the upcoming BRPU proceeding.

8 Paying SO1 prices, per PG&E's suggestion, would put Southeast in the same situation as QFs who "missed" the suspension deadline for SO2 (and entered into a SO1 to await SO2 reinstatement). Paying "zero" for capacity would actually put Southeast in a worse position since, under SO1, a QF would receive variable payments for both energy and capacity.

9 Our suspension order expressly stated that SO2 contracts executed before March 19, 1986 were not affected by the order. See D.86-03-069, Conclusion of Law 1.

10 See D.87-09-025, page 5. In its protest, PG&E argues that Southeast's right to receive levelized firm capacity payments is contingent upon PG&E's need for capacity on Southeast's actual operation date. PG&E is wrong. In making its assertions, PG&E inappropriately relies on our discussions of possible future changes to SO2, which include linking the availability of levelized prices to a "need threshold." (See D.88-09-026, pp. 38-42.) While the level of Southeast's firm capacity prices will clearly depend on PG&E's capacity needs, the availability of fixed, levelized payments will not.

11 See D.86-11-071, page 4 and finding of fact (FOF) 12; D.88-03-079, pp. 6-8 and FOF 5.

Specifically, during Phase 1 of the BRPU, we will assess the long-term resource needs of all three major electric utilities. During Phase 2, we will update each utility's long-term capacity values, based on our determinations in Phase 1.¹² Hence, as DRA suggests, the BRPU is the logical forum for updating Southeast's firm capacity schedule.

Alternatively, we could develop a current resource plan and capacity schedule for PG&E outside of the BRPU, or on an expedited schedule within our BRPU schedule. We agree with PG&E, however, that this option is unduly burdensome to the Commission and other interested parties.

Therefore, absent a negotiated settlement, Southeast's firm capacity schedule will be based on the long-term capacity value adopted in the BRPU for PG&E. Since our schedule for completing Phase 2 is uncertain, however, we also need to specify an "interim" payment schedule for Southeast.

We think that a workable approach would be to pay Southeast based on the most current short-term capacity value available, i.e., using the Energy Reliability Index (ERI) developed in PG&E's Energy Cost Adjustment Clause (ECAC) proceeding and the latest established combustion turbine cost. In developing both the interim and final capacity schedule for Southeast, payments should be ramped for inflation, and then levelized, using an appropriate

¹² The supply and demand assumptions used to update SO2 capacity values will be derived from the resource plan scenario adopted for our "long-run" offer, Standard Offer 4 (SO4). As described in D.86-11-071, we update SO2 capacity values assuming the full subscription of Standard Offer 4. For the BRPU phasing schedule, see the ALJ's Ruling dated April 19, 1989 in A.82-04-044 et al.

discount rate.¹³ Once we establish a long-term firm capacity schedule for PG&E (in the BRPU), Southeast should be "made whole" for any resulting underpayments during the interim payment period. Similarly, in the event that Southeast is overpaid during the interim payment period, its subsequent capacity payments should be "discounted" until ratepayers are made whole.

As stated above, we agree with both PG&E and Southeast that negotiations should be allowed to proceed. Rather than await our determinations in the BRPU, PG&E and Southeast are free to pursue negotiations for updating Southeast's firm capacity schedule. However, any negotiated settlement should reflect today's determinations; namely, that capacity payments are to be (1) based on current forecasts of PG&E's long-term resource needs and (2) fixed and levelized over the term of the contract.

PG&E should keep us apprised of the status of negotiations with Southeast and similarly situated QFs. Should negotiations prove unproductive, we will direct PG&E to file (in the BRPU) proposed interim and final firm capacity schedules for QFs selecting the future price schedule option.

Findings of Fact

1. By D.82-12-120, D.83-10-093, and D.84-03-092, we made SO2 available to QFs for the purchase of as-available energy and firm capacity.
2. SO2 was designed for QFs that could commit firm capacity to the system and meet certain performance requirements.

¹³ The most recently adopted discount rate for PG&E should be used for this purpose (e.g., the one adopted for use in PG&E's 1990 general rate case). The latest established combustion turbine cost will be escalated using the previous year's recorded GNP deflator. (See D.87-05-060, mimeo, page 29.) Consistent with our determinations in D.86-11-071, the ERI after year 12 should be fixed at 1.0. (See D.86-11-071, page 10.)

3. SO2 capacity prices are based on long-term forecasts of the utility's loads and resources. They are fixed and levelized for the whole term of the contract (up to 30 years).

4. Under Article 3 of PG&E's existing SO2, a QF can elect to have capacity prices based on the firm capacity price schedule in effect either (1) on the date of contract execution or (2) on the date of actual operations ("the future price schedule option").

5. In D.83-12-068, the decision in PG&E's general rate case, we established firm capacity prices for QFs with on-line dates through 1988.

6. By D.86-03-069 and D.86-05-024, we suspended the availability of SO2.

7. Our suspension orders applied to prospective QFs only; SO2 contracts executed before March 19, 1986 were not affected by the orders.

8. By D.87-09-025, we extended the original capacity price schedule adopted in D.83-12-068 to cover on-line dates for the years 1989 to 1991.

9. D.87-09-025 specifically excluded QFs that elected the future price schedule option from using the extended capacity prices.

10. SO2 is still suspended for PG&E. The Commission will address SO2 reinstatement issues during Phase 2 of the Biennial Resource Plan Update (BRPU) proceeding.

11. In D.86-11-071 and D.88-03-079, we directed that future SO2 firm capacity schedules be based on the long-term resource plans adopted for final S04.

12. On July 13, 1988, Southeast filed a petition to modify D.83-12-068, the decision in PG&E's 1984 general rate case.

13. Southeast holds an executed SO2 contract with PG&E. At the time of contract signing, Southeast elected the "future price schedule" option for capacity payments.

14. Under the terms of its contract, Southeast must commence actual operations by December 22, 1991.

15. In its petition, Southeast asks the Commission to specify the firm capacity prices it should receive if actual operations commence while SO2 is still suspended.

16. Paying zero or SO1 variable prices for capacity (until SO2 is reinstated) is tantamount to suspending SO2 retroactively for Southeast.

17. To develop a new PG&E resource plan and capacity schedule outside of the BRPU, or on an expedited basis, would be unduly burdensome to the Commission and other interested parties.

18. During Phase 1 of the BRPU, the Commission will assess the utilities' long-term resource needs. During Phase 2, the Commission will update long-term firm capacity prices, based on the resource plans adopted in Phase 1.

19. The schedule for completing Phase 2 of the BRPU is undetermined at present.

Conclusions of Law

1. Southeast and other QFs who elected the future price schedule option under PG&E's existing SO2 should receive fixed, levelized firm capacity payments over the term of their contract.

2. These QFs are not entitled to the firm capacity prices established in D.83-12-068, and extended by D.87-09-025.

3. PG&E and Southeast should proceed to negotiate a firm capacity schedule, consistent with the clarifications provided in this order.

4. Absent a negotiated settlement, Southeast's firm capacity schedule should be based on the long-term capacity value adopted for PG&E in Phase 2 of the BRPU.

5. If Southeast commences actual operations prior to our completion of Phase 2 of the BRPU Southeast's firm capacity schedule should be based on the most current, short-term capacity value adopted for PG&E.

6. This order should be effective today so that PG&E and Southeast may proceed immediately with further negotiations.

O R D E R

IT IS ORDERED that:

1. By November 30, 1989, Pacific Gas and Electric Company (PG&E) shall file a report on the status of Southeast Energy, Inc. (Southeast), and similarly situated QFs. PG&E shall submit this report as a compliance filing in the Biennial Resource Plan Update (BRPU) proceeding, currently docketed as A.82-04-044 et al. Copies shall be served on all parties of record in that proceeding.


2. Absent a negotiated settlement, the interim and final firm capacity schedules for Southeast and similarly situated QFs will be developed during the BRPU, consistent with the discussion on pages 6 to 9 of this order.

This order is effective today.

Dated JUL 6 1989, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

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


Victor Weiss, Executive Director
DB