

ORIGINAL

Decision 90 07 019 JUL 6 1990

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
 Pacific Power & Light Company)
 (U 901 E) for Authority to Enter)
 Into an Electric Service Agreement)
 with Alturas Lumber Company Under)
 the Accelerated Approval Guidelines)
 of the Expedited Application Docket,)
 or Alternatively, Under the)
 Provisions of Sections 455 and 491)
 of the Public Utilities Code.)

(EAD)
 Application 89-10-005
 (Filed October 6, 1989)

Stoel, Rives, Boley, Jones & Grey, by
Thomas H. Nelson, Attorney at Law, for
 Pacific Power & Light Company, applicant.
John P. Baker, Attorney at Law, for the City of
 Alturas; and Sean Casey, for the Division of
 Ratepayer Advocates; protestants.

O P I N I O N

Statement of Facts

Early in the second half of the 1980 decade, the existence of a short-term electric energy surplus capacity in California, derived largely from the addition to rate base of large, capital-intensive baseload plants, resulted in noticeable rate increases which in turn made it attractive for more and more customers to consider building and operating their own generating units, thereby bypassing utility systems. In reaction, the Commission permitted utilities to attempt retention of these customers on system by offering special contracts at rates that differed from the tariff rate that otherwise would have applied to these customers.

But use of these special contracts created another concern in that because of Electric Revenue Adjustment Mechanisms (ERAM), the entity relied upon to negotiate the special contracts

had no direct economic incentive to negotiate the highest price that would still retain the customers or even to try to keep these customers on the system. Under ERAM all risk of sales and revenue variation was assigned to ratepayers. Removing ERAM would put utilities at risk for the results of negotiations with customers, and make it a utility goal to maximize net revenues from the class of larger light and power customers, those most likely to bypass. Accordingly, in 1987 the Commission determined to consider removing ERAM for the revenue from this class, and concluded that utilities should be permitted to enter into special contracts with this class of customers with the special contracts to be governed by general guidelines (Interim Decision (D.) 87-05-071 in Rulemaking (R.) 86-10-001).

During en banc hearing and workshops the Commission became convinced that giving management greater flexibility over a utility's earnings was precisely the sort of incentive it hoped to introduce into California regulation; that after ERAM was eliminated, utilities should have greater freedom to negotiate agreements that would maximize net revenues. However, it also decided that until sales to the larger light and power class had no influence on other rates it would maintain guidelines to assure that other customers were not unreasonably disadvantaged by such contracts. It determined to encourage innovative approaches, and to encourage customers to develop their long-term plans in a manner consistent with the utility's expected needs.

Initially, by Resolution ALJ-159 adopted June 15, 1987, the Commission established an Expedited Application Docket (EAD) on an experimental basis for a period of one year and limited to contracts to prevent bypass or substantial energy reductions by fuel switching. The guidelines of the docket were not intended in any way to limit the utilities' ability to negotiate special contracts with their customers; rather, their sole purpose was to allow for a faster review than would otherwise occur. The goal was

to develop a set of safeguards that would assure that contracts conforming to the guidelines meet certain key standards and did not disadvantage other ratepayers.

The procedure proved useful, but experience pointed up the need for similar treatment for contracts for incremental sales, i.e. sales that would not be made under existing tariff rates, additional sales that would be made only because of a utility's ability to offer discounted rates. Thereupon, on April 12, 1989 the Commission adopted Resolution ALJ-161 establishing a revised EAD on an experimental basis for another year. As relative here, this latter EAD provided for special service contracts offered expressly to:

- "a. Prevent a customer from bypassing a utility's gas and/or electric system or from substantially reducing its requirements by fuel switching, or
- "b. Allow a utility to make additional electric sales that would not be made at existing tariff rates."

Pacificorp, an investor-owned Oregon corporation based in Portland, Oregon, is an electric utility whose service territories cover parts of seven states in an arc curving eastward from the Pacific Northwest to Utah. Pacificorp does business as Pacific Power & Light Company (Pacific) in the State of California, and is a public utility within the jurisdiction of this Commission. Among its customers in northeastern California, Pacific serves the 3,000 people in the City of Alturas in Modoc County.

Alturas Lumber Company (Alturas Lumber), a subsidiary of WTD Industries, Inc. (WTD), the fourth largest lumber company in the United States, and through other WTD subsidiaries, a valued customer of Pacific, recently purchased from Calendor Pine, a pine lumber mill consisting of a sawmill and planer located outside the city limits of Alturas. This Alturas mill, the largest employer in

the area, and a Pacific customer for over 25 years, during the most recent 24 months of adjusted operation has purchased an average of more than 480,000 kWh per month from Pacific. The principal source of electric power to operate the mill is now obtained from a distribution line from Pacific's Goose Lake substation, part of Pacific's local distribution underbuild from Pacific's 69 kV transmission line from the Oregon-California border. There is also a small additional service at the end of an underground line running from the underbuild.

The lumber company, currently operating on a one-shift basis, is contemplating starting a second shift. A second shift would approximately double the present power purchase. An important cost component is the cost of power. Other considerations are availability of raw materials at a reasonable cost, labor costs, and market conditions. The company is also considering converting its steam-driven log carriage to an electric-powered system, which would make the mill more productive and competitive. Extended mill operations could produce a positive ripple effect upon the community's economy.

In February of 1987, initiating a plan conceived in conjunction with Surprise Valley Electrification Corporation (Surprise Valley),¹ the City of Alturas (City of Alturas) filed

1 Surprise Valley is an electrical cooperative organized under the Rural Electrification Administration. As such it receives Bonneville Power Administration (BPA) power at a priority firm rate. A full requirements customer of BPA, it purchases all its energy requirements at a very favorable price from BPA. While its office is in Alturas, its customers are mostly isolated ranches that could not profitably be served by investor-owned utilities. As an electrical cooperative corporation under California law (Public Utilities (PU) Code § 2776), except as specified in PU Code § 2777 (dealing with establishing rates, borrowing money, issuance of debt, or the sale, lease, mortgage, or other disposal or

(Footnote continues on next page)

an action in Modoc County Superior Court, an action later removed on diversity grounds to the U.S. District Court for the Eastern District of California, seeking through a creative use of the City's eminent domain powers to take Pacific's facilities in and about the City. In recognition of the fact that the City lacks the requisite expertise to itself operate the facilities, it was its plan to put the acquired facilities to bid, with the contemplation of Surprise Valley becoming the buyer, and thereafter, by use of the federal power preference afforded Surprise Valley, obtain lower electric rates for Alturas inhabitants than those which can be offered by Pacific.

Following trial, the District Court on May 1, 1989 entered judgment on the condemnation issues for the City, including a right to take the Goose Lake substation and electrical distribution served by the substation, which in turn serves the lumber mill. The Court's order provides that upon payment to the Court of the \$6 million just compensation award of the jury, plus interest, the City can obtain a final order of condemnation. Title would pass to the City when such a final order is recorded in the Modoc County Recorder's Office. To date the City has not chosen to tender the money or sought an order of possession. On June 5, 1989 Pacific filed an appeal to the U.S. Court of Appeals for the Ninth Circuit. It further appears that to date there has been no decision on the appeal.

(Footnote continued from previous page)

encumbrance of electrical cooperative property), Surprise Valley is subject to Part 1 of the PU Code. Pacific and Surprise Valley bitterly compete in Modoc County, and for decades this Commission has exercised exclusive jurisdiction over territorial augmentations for both (see D.47987 (issued in 1952) and D.84-08-119 prescribing the respective service territories of the two entities).

Meanwhile, on February 2, 1989, Pacific filed a complaint, Case (C.) 89-02-004, before the Commission seeking an order restraining Surprise Valley from asserting any degree of operation, maintenance, or control over the public utility system in the Alturas area presently owned by Pacific, actions which Pacific asserts would be in violation of the PU Code and D.47987.² Pacific and Surprise Valley thereafter filed a number of lengthy responses and motions on the issues. On August 10, 1989 Administrative Law Judge (ALJ) John B. Weiss issued a ruling reminding the parties that Surprise Valley is subject to provisions of Part 1 of the PU Code, and that therefore, before Surprise Valley can acquire or control, either directly or indirectly, any public utility, or extend Surprise Valley's system, it must first secure authorization pursuant to PU Code §§ 854 and 1001, respectively, from this Commission. Surprise Valley has filed no such application.³

It was against this backdrop of contentions and unsettled conditions that Pacific and Alturas Lumber on July 28, 1989 made an incremental sale agreement which is the subject of the present EAD

2 Pacific is resisting any acquisition by its rival utility, Surprise Valley, of its Alturas system, contending that the loss of revenue would have a substantial negative impact upon Pacific's California operations and could lead to substantial increases in electric rates for Pacific's remaining California customers; that Surprise Valley really threatens to take over all of Pacific's California service territory by employing this "cherry picking" condemnation and transfer scheme.

3 However, the City of Alturas in August of 1989 filed a Petition for Writ of Mandate/Prohibition before the California Supreme Court, asserting that the Commission, through the ALJ's ruling, was exercising powers in excess of its jurisdiction, and asking that a peremptory writ of prohibition or mandate be issued commanding the Commission to desist and refrain from proceeding, or to dismiss Pacific's complaint. In October of 1989 the California Supreme Court denied Alturas' petition.

application. If approved by the Commission, Pacific asserts that the effect would be two-fold: to remove the possibility that the lumber company will bypass Pacific's Modoc County system to become a customer of Surprise Valley (even should the City of Alturas proceed with condemnation and subsequently accomplish a transfer of a seized Pacific distribution system to Surprise Valley), and to provide the lumber company the incentive to operate a second shift in Alturas which would result in incremental sales to Pacific.

By its application Pacific seeks authorization from the Commission to enter into a 5-year contract with Alturas Lumber, which contract would provide the latter with a lower industrial rate for incremental energy purchases than otherwise applicable under Pacific's tariff, and would eliminate bypass of Pacific's system by the lumber company. Pacific asserts that loss of the customer's load would be uneconomic to its other California customers; that by retaining the customer, whether or not the mill's consumption patterns remain stable or increase, the mill will be making net revenue contribution to Pacific's fixed costs, thereby providing significant benefits to Pacific's other customers.

At unchanged energy usage levels, Pacific's standard industrial prices under Schedule AT-48 would continue for all consumption by the lumber company.⁴ However, the price of expanded electrical usage would be reduced by 2 cents per kWh (\$0.020/kWh) during the first 3 years of initial 5-year term of the agreement. During the final 2 years the price reduction for incremental sales would be phased out by 1/24 per month, so that at the end of the initial 5-year term, the terminal price would equal the price applicable in Pacific's Schedule AT-48 tariff. The agreement also provides for possible extensions beyond the 5-year

4 Current average monthly usage is 482,964 kWh per month.

initial term. It would also be subject to Commission modifications over its term.

The agreement further provides that Pacific is to contribute \$100,000 in conservation enhancements for the purposes of installing energy efficient equipment and introduction of measures to increase the energy efficiency of the mill. Pacific would also be obligated to maintain a single point of delivery for electric power from the low side of its 69 kV transmission line.⁵ At present this would be Pacific's Goose Lake substation, or in the event the City exercises its condemnation rights and takes the substation and its distribution line to the mill, Pacific must immediately place a tap on its 69 kV transmission line with a transformer to maintain service to the mill, in essence bypassing the condemned substation and distribution line.

Pacific's EAD application was protested by the City of Alturas which asserted that the City has been awarded the right to take the facilities serving the mill, and that the Commission lacked jurisdiction to determine whether the City could serve the mill. The City also believes the application to be defective in that the purpose of EAD was to provide means to deter building of self generation facilities or to approve incremental sales contracts, not to deter municipal condemnation actions, and finally that Pacific had not factored in the cost of a new substation it would have to build if the City took the Goose Lake facility.

The Division of Ratepayer Advocates (DRA) also protested the application as an EAD, suggesting that it be refiled as a simple incremental sales contract and not implicate issues involved in the condemnation actions in federal courts. Alternatively, DRA

⁵ Prior to trial in the District Court, the City dismissed from its condemnation action certain Pacific facilities, including the 69 kV transmission line from the Oregon-California border.

would consolidate the application with Pacific's presently quiescent complaint proceeding, C.89-02-044. However, DRA would not object to EAD review of what it terms an "ill-defined incremental sales contract", were the Commission (1) to place any risk upon Pacific of the marginal cost increasing above the discounted sales rate given the lumber company; (2) to require Pacific, before applying the discounted incremental sales rate to incremental sales, to increase the mill's normal consumption load by any increased load attributable to increased efficiency derived from the \$100,000 conservation enhancement contribution; and (3) to require that Pacific's shareholders be specifically at risk under the "hold harmless" contract terms on account of Alturas Lumber continuing Pacific service. DRA also recommends that reasonableness of the contract be reviewed in a future proceeding.

Pursuant to the procedure provided under the EAD established by Resolution ALJ-161, on November 6, 1989 ALJ Weiss conducted a workshop in San Francisco in which representatives of Pacific, the City of Alturas, and DRA participated. At conclusion of the workshop the matter was submitted subject to transmittals dated November 9, 16, and 24 from the City, and November 16, 1989 from Pacific, of maps and other data including submissions in the Court proceedings and information on the second metering point at the mill.

In D.88-03-008, we established guidelines for review of special contracts intended to defer bypass or attract incremental load for certain specific utilities, Pacific Gas and Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company. These guidelines included: a floor price to protect other ratepayers from negative margin contributions, a minimum customer size of 1,000 kW for consideration of a special contract, a maximum term of three years for incremental sales contracts, and time-differentiated rates. The guidelines were intended not as final rules for our approving a contract, but only

as a checklist to speed consideration of contracts that do conform. As we concluded in that guidelines decision: "All special contracts should be reviewed under the Expedited Application Docket (EAD)", and "Special contracts not conforming to the guidelines may still be approved if the utility can demonstrate that the contract is fair to other ratepayers". (27 CPUC 2d, 486.) Although not specifically applicable to Pacific, this basic test has been our focus in considering the proposed contract.

Discussion

Originally introduced to address only those special contracts aimed at deterring bypass or to prevent reduced requirements due to fuel switching, the applicability of the EAD procedure since inception over three years ago has been expanded specifically to include all special contracts, including those for incremental sales that would not be made at existing tariff rates. Most recently, Resolution ALJ-161 extended the procedure applicable to this application.

The innovative special contract which is the subject of this EAD application fundamentally adheres to this concept. It is expressly designed to protect Pacific's California system ratepayers from the adverse effect of reduced contributions to Pacific's ongoing fixed costs which result would stem from loss of this very important mill customer. It is also well designed to possibly provide them with significant other benefits. Besides providing a strong incentive to the present mill customer to remain with Pacific, the contract very significantly encourages the mill to add a second shift, thereby encouraging substantial incremental sales that otherwise would not be made. Loss of the customer would reduce contributions to fixed costs by an estimated \$491,000 during the term of the contract. But even should the mill's usage merely remain stable, there would be no loss of contributions to margin. Thus, both Alturas Lumber's and Pacific's other ratepayers in northern California will benefit. Also, addition of a second shift

would bring needed new jobs to the community, with benefits to all the local economy. And Pacific has sufficient energy resources for the period.

The application meets the requirements set forth in Resolution ALJ-161. It states that the contract is with one existing customer, Alturas Lumber. There is included an affidavit from the Executive Vice President of WTD, parent of Alturas Lumber, in which for the latter it is agreed to forego taking service from Surprise Valley if and when offered, and to continue with Pacific in exchange for a reduced rate for supplemental sales and a \$100,000 energy enhancement contribution from Pacific. It states that the reduced rate for supplemental sales makes more likely supplemental sales that could not be made at existing rates. Pacific's supporting explanation under penalty of perjury demonstrates that the deviation is necessary to retain the customer and to induce supplemental sales; that under the contract, even if present usage only remains stable, there would be no loss of contribution to margin. On the other hand, Pacific's commitment to price stability, reflecting its recent merger with Utah Power and Light Company and resulting increased efficiencies, means that if usage increases over historical levels no customer class will be asked to make up lost contributions to margin through 1992. In the absence of possible price increases in the last 2 years of the 5-year contract, proposed prices appear from the tables supplied by Pacific to be more than sufficient to offset usage-related costs. But since the discounted sales rate is only 1/2 cent per kWh above forecast marginal costs we agree with DRA that Pacific's shareholders should carry the risk of Pacific's marginal cost

rising above the discount offered to Alturas Lumber during these final 2 years of the 5-year contract.⁶

Pacific also offered tables that show that its anticipated incremental revenues during the first year of the contract are also sufficient to cover the \$100,000 contribution to the mill's energy efficiency improvements. And if they are not, Pacific's attorney at the workshop stated that Pacific's shareholders would be more than willing to underwrite any deficiencies. DRA also points out the linkage between the use of the energy conservation funding and incremental sales. DRA points out that the increase in electric load resulting from energy conservation fund funding of electric-driven machinery to replace steam-driven machinery currently using waste product fuel should not be eligible for the discounted incremental sales rate. We agree, and will require that this increased load be added to the plant's normal consumption for purposes of determining incremental sales. Calculations to this point will be included in any Pacific ratemaking request.

While some previous approved contracts (for Southern California Edison Company) have been to require customers taking power in the on-peak period to reflect approximate price differentials used in the applicable time-of-use tariff, energy costs on Pacific's system do not differ by time of day due to Pacific's unique mix of hydro and thermal resources, and therefore

⁶ Over the 5-year term, the discounted sales rate is 1/2 cent per kWh above forecast marginal cost of providing service (these latter costs are taken from Schedule CG-5, Purchase from Cogenerators and Small Power Producers. Losses from marginal cost study filed March 1986, escalated 5.19% per year to reflect 1989 dollars). Pacific will be required to report on marginal energy costs and the discounted rate to Alturas Lumber in any Pacific general rate case proceeding applicable to the last 2 years of this 5-year contract.

Pacific offers no time-differentiated energy prices in its applicable tariff, and no such pricing differentials are used in this contract. Nor will we require them.

We agree with DRA that Pacific's shareholders should be at risk for Pacific holding Alturas Lumber harmless for claims and liability asserted against the latter on account of continuing to take Pacific's service. And in view of the uncertain nature of Pacific's needs for electric capacity for the future we will limit approval of the contract to a 5-year term. However, if future developments indicate that an extension is desirable, Pacific may subsequently file an advice letter seeking such.

The Commission is well aware of a potential condemnation apparently now marking time. But nothing herein prevents the City of Alturas from proceeding with acquisition of the Pacific facilities which were the subject of its condemnation action in Federal District Court. The City has only to tender the condemnation award monies and receive and record an order of possession in order to take possession for itself of the Pacific facilities included in that action. But the City has also conceded its inability itself to operate the Pacific distribution system it would take. Its stated intention would be either to have Surprise Valley on an interim basis, lease and operate it, or to arrange a sale to Surprise Valley of the facilities.

The Pacific system in Alturas is a public utility, and as PU Code § 1001 makes clear, its acquisition by the City does not mean it would cease to be a public utility, rather that it continues to be a public utility, albeit one owned by a municipality. And as long as the public utility is owned and operated by the municipality, such municipal public utility would not be within the jurisdiction of this Commission.

But PU Code § 216(c) provides in relevant part that when any nongovernmental corporation performs any service for, or delivers any commodity to any municipality, which in turn either

directly or indirectly, mediately or immediately, delivers that commodity to the public or any portion thereof, that corporation is a public utility subject to the jurisdiction, control, and regulation of the Commission and provisions of Part 1 of the Public Utilities Act. Furthermore, Surprise Valley being an electrical cooperative corporation under California law, except as specified in PU Code § 2777, it is subject to Part 1 of the Act. Pursuant to PU Code § 854 (a code section within Part 1 of the Act), before Surprise Valley can acquire or control, either directly or indirectly, any public utility it must first secure authorization to do so from this Commission. In addition, before extending its present system it must, pursuant to PU Code § 1001, first obtain from the Commission a certificate of public convenience and necessity.

For decades the Commission has, as both the City of Alturas and Surprise Valley are well aware, exercised exclusive jurisdiction over territorial augmentations for both Pacific and Surprise Valley, and no municipality, or condemnation court can empower Surprise Valley to acquire or control the Pacific system in and about Alturas, directly or indirectly, and thereby extend its service territory indirectly; without the prior authorization of this Commission for such control, acquisition, and/or expansion. The function of the Commission is to protect and safeguard the interests of the public, all of the public.

To date, Surprise Valley has made no application to control or acquire these public utility functions. Meanwhile, Pacific continues to own and operate the local distribution system serving in and around Alturas, as well as the 69 kV transmission line from the Oregon-California border which passes close to the mill. The condemnation may never be consummated, or if consummated, Surprise Valley may not be authorized to control or acquire the public utility. Pacific has Commission authorization

to serve as well as a county franchise to do so. Business goes on, and we will not delay longer over what may never come to pass.

Accordingly, this contract will be approved, but will be conditioned on a subsequent review of reasonableness in a future rate proceeding.

Findings of Fact

1. Pacific and Alturas Lumber have negotiated a 5-year agreement for continued electric service whereby the mill will receive service over the life of the agreement with supplemental sales at rates below Pacific's filed tariff rates.

2. If the agreement is not approved, Alturas Lumber may leave the Pacific system, causing Pacific's other northern California ratepayers to lose approximately \$491,000 contribution to margin over the term of the agreement.

3. The threat of a bypass is credible.

4. The agreement greatly diminishes severe potential harm to Pacific's other northern California ratepayers by lessening the likelihood of implementation of a takeover plan by the City of Alturas and Surprise Valley.

5. The time period of the agreement is within Pacific's expected period of sufficient energy resources.

6. In the absence of possible price increases in the last 2 years of the agreement, anticipated supplemental sale revenues appear more than sufficient to offset usage related costs, and Pacific's shareholders will carry the risk of any deficiency of marginal costs rising above the discounted price during the final 2 years of the 5-year agreement.

7. Anticipated revenue during the first year of the agreement, when Pacific will make the contribution, is sufficiently in excess of the marginal costs of providing the service to cover the cost of the \$100,000 energy efficiency contribution to be made under the agreement to Alturas Lumber, and if not, Pacific's shareholders will bear the risk of any deficiency.

8. The term of the agreement should be limited to 5 years with possible renewals to be processed by advice letter proceedings.

9. The terms of the agreement are in compliance with the requirements set forth in Commission Resolution ALJ-161, and the EAD application was filed within the effective period of the resolution.

10. The agreement should be conditioned on a subsequent review of reasonableness in a future rate proceeding.

11. The matter is not sufficiently controversial to warrant the regular hearing process.

Conclusion of Law

The agreement should be approved with the limitations noted.

O R D E R

IT IS ORDERED that:

1. The electric service agreement between Pacific Power & Light Company (Pacific) and Alturas Lumber Company (Alturas Lumber) is approved, subject to subsequent review of reasonableness in a future rate proceeding, for a term of 5 years.

2. Pacific's shareholders are at risk for any deficiency of marginal energy costs arising above the discounted price during the final 2 years of the agreement.

3. Pacific's shareholders are at risk for any deficiency of revenues falling below the marginal costs of providing service to cover the cost of the \$100,000 Pacific energy efficiency contribution to Alturas Lumber.

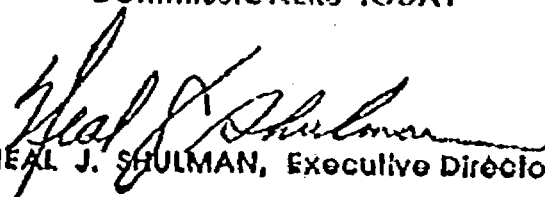
4. Pacific's shareholders are at risk for any costs incurred in holding Alturas Lumber harmless as a consequence of the latter continuing to take Pacific service.

This order becomes effective 30 days from today.

Dated JUL 6 1990, 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


NEAL J. SHULMAN, Executive Director

PS