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Decision 91-11-016 November 6, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Application of PACIFIC GAS AND ELECTRIC COMPANY for Authority to Adjust its Electric Rates Effective November 1, 1990; and for Commission Order Finding that PG&E's Gas and Electric Operations during the Reasonableness Review Period from January 1, 1989, to December 31, 1989, were Prudent. (U 39 M)	Application 90-04-003 (Filed April 2, 1990)

(Appearances are listed in Decisions 90-10-062, 90-12-066, and 91-07-009.)

Additional Appearance

Robert Cagen, Attorney at Law, for the Division of Ratepayer Advocates.

OPINION ON SPECIAL ELECTRIC CONTRACTS

1. Summary of Decision

The Commission concludes that with one exception, Pacific Gas and Electric Company's (PG&E) special electric contracts were reasonable during the 1989 record period. In the case of a PG&E contract with Arco, a disallowance of $17,161 is ordered because the contract did not yield a positive contribution to margin in connection with service to Arco's North Coles facility. A contract with Texaco is reviewed for the first time and found to be reasonable.

The Commission also reviews a contract with Chevron U.S.A., Inc. (Chevron) which became effective during the 1988 record period. The floor price covers the marginal cost that PG&E incurs in providing electric service to Chevron at its Richmond refinery, and is therefore reasonable.

2. Background

2.1 Special Electric Contracts

Since 1986, PG&E has entered into agreements with large electric customers, offering them electric rates below the tariff rates that would otherwise apply in exchange for a promise by them either to forgo or to defer self-generation. PG&E has offered these special contracts to customers that it determined were particularly likely to begin self-generating in the near future. In negotiating these contracts, PG&E considers the customer's competitive alternatives and attempts to set the rate at the level at which the customer is indifferent to whether it obtains electricity by means of PG&E service or the alternative of self-generation.

The Commission has adopted policies and procedures for special electric contracts in a series of actions that began in 1987. In Decision (D.) 87-05-071, we discussed the appropriateness of allowing the limited use of such contracts for customers of PG&E, Southern California Edison Company, and San Diego Gas & Electric Company. We found that while these contracts present several problems, such as the potential for unreasonable discrimination, under the right conditions they can be useful in retaining potential bypassers on the system and can provide an overall benefit to ratepayers. By D.88-03-008, we issued guidelines for expedited prior approval of special electric contracts. In D.89-05-067, we evaluated the role of special electric contracts under changing market conditions, and ordered that the reasonableness of special electric contracts be reviewed in the reasonableness phase of each electric utility's annual Energy Cost Adjustment Clause (ECAC) proceeding.

On December 27, 1990, we issued D.90-12-128 in Application (A.) 89-04-001, an earlier ECAC proceeding. In that decision we considered the reasonableness of PG&E's special electric contracts for the first time. As it was the first such review, we established general criteria for reasonableness reviews. One such criterion is that the contracts should include a floor price designed to allow the utility to recover the marginal cost of serving the customer, with components reflecting energy costs, generation capacity costs, transmission and distribution (T&D) capacity costs, and customer costs.

In D.90-12-128, we determined that a contract is unreasonable if it does not include adequate floor price provisions and provide for a contribution to margin (the amount by which the revenues received from a customer exceed the marginal cost of service). For each record period during which such a contract yields a negative contribution to margin, the Commission will order a disallowance in that amount. The disallowance is subtracted from the allowable recovery in the Electric Revenue Adjustment Mechanism (ERAM) balancing account for special contracts.

2.2 Procedural History

Because a decision on PG&E's pre-1989 special electric contracts had not been issued when reasonableness phase hearings were scheduled in this docket, the Division of Ratepayer Advocates (DRA) requested that the review of PG&E's special electric contracts for the 1989 record period be deferred pending a decision in the earlier proceeding. PG&E concurred with the request, which was granted by the administrative law judge (ALJ) with the establishment of a separate procedural phase.

D.90-12-128 concluded the Commission's review of PG&E's special electric contracts for 1988 and earlier record periods, with the exception of a contract with Chevron. Review of the Chevron contract for 1988 was deferred in part to this proceeding. Following issuance of D.90-12-128, the ALJ assigned to this proceeding established a schedule for hearings on special electric contract administration and execution in 1989. An evidentiary hearing was held on May 20, 1991, and the matter was submitted with the filing of reply briefs on June 18, 1991.

The proposed decision of the ALJ was filed on October 7, 1991. No comments have been received. The findings, opinion, and order made in the proposed decision are confirmed.

2.3 Status of A.90-04-003

By D.91-07-009 dated July 2, 1991, the Commission concluded its reasonableness review for PG&E's 1989 operations, with the exception of certain deferred matters. In addition to special electric contracts, these included gas-related costs and operations at PG&E's Geysers Unit 15 which will be considered in conjunction with Investigation (I.) 90-02-043. (D.91-07-009, Ordering Paragraph 3.)

On July 25, 1991, by a joint ruling, the ALJs assigned to this application and PG&E's 1991 ECAC application (A.91-04-003) ordered that "[e]xcept for special electric contracts issues, currently under Commission consideration in A.90-04-003, and Geysers 15 issues consolidated with I.90-02-043, all remaining reasonableness issues pending in A.90-04-003 are hereby removed and transferred to A.91-04-003."

Today's decision completes the special electric contracts phase of A.90-04-003. Since other reasonableness issues have been transferred to A.91-04-003, A.90-04-003 will remain open only for consideration of Geysers Unit 15 issues which have been consolidated with I.90-02-043. Ordering Paragraph 3 of D.91-07-009 will be superseded by this order to the extent that the former provided that A.90-04-003 remains open for consideration of gas system issues and gas-related electric system issues.

3. Uncontested Issues

PG&E and DRA were the only parties to submit testimony and briefs on special electric contract issues. With the adoption of criteria for reasonableness reviews in D.90-12-128, there were few contested issues in this case. During the proceeding, PG&E and DRA resolved all issues except those related to the Chevron contract.

DRA reviewed each of the special contracts in effect during the record period. DRA analyzed each contract and calculated its contribution to margin. DRA obtained the same or similar results that PG&E did in its analysis. DRA explained that the slight differences in their contribution to margin calculations are due to the different methods used for applying summer and winter billing determinants. DRA indicates that its method is a more accurate way of measuring costs for billing periods which include both summer and winter costs.

DRA found that with one exception, all ten contracts, including the Chevron contract, yielded positive contributions to margin in 1989.[1] DRA recommends, and PG&E agrees, that a disallowance of $17,161 should be ordered in connection with the North Coles portion of PG&E's contract with Arco. That disallowance results from the facility's negative contribution to margin in that amount.

DRA agrees that a new contract with Texaco, the only one to become effective in 1989, was executed in accordance with the guidelines adopted in D.88-03-008 and is reasonable. The Texaco contract defers a planned 16,668 KW cogeneration facility planned for Texaco's Bakersfield refinery.

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1 The testimony in this proceeding contains conflicting references to the number of special electric contracts in effect. For example, Exhibit 55 contains references to "...the ten contracts that were reviewed in the 1989 Reasonableness proceeding..." and to an eleventh contract that became effective during 1989 (the Texaco contract). Exhibit 62 indicates there are just ten contracts.

The record shows that as of year-end 1989, PG&E had entered into ten special electric contracts with the following customers: Mills Hospital, Peninsula Hospital, Sequoia Hospital, Louisiana Pacific, Arco, Unocal, Shell, USS Posco Industries, Chevron, and Texaco. The confusion apparently arises from the fact that the Arco contract involves two separate facilities which are evaluated independently in accordance with D.90-12-128.

In D.90-12-128, we concluded that PG&E should not be allowed recovery of revenue shortfalls in the Arco contract which result from inadequate floor provisions. (Conclusion of Law 11.) Accordingly, we now conclude that a disallowance of $17,161 should be ordered due to failure of the North Coles portion of the Arco contract to yield a positive contribution to margin during 1989. With that exception, PG&E's special electric contracts with Mills Hospital, Peninsula Hospital, Sequoia Hospital, Louisiana Pacific, Arco, Unocal, Shell, USS Posco Industries, and Texaco were reasonable and no disallowance should be ordered for 1989. A detailed discussion of each contract is not necessary.

The remaining issues to be resolved are whether the floor price of the Chevron contract is reasonable, and if not, whether there should be a disallowance for a negative contribution to margin during 1988. There is no dispute that the Chevron contract yielded a positive contribution to margin during 1989.

4. The Chevron Contract

4.1 Background and History of the Contract

Chevron is PG&E's largest electric customer. While some of PG&E's large customers own their own transformation facilities and receive electric service under transmission voltage rate schedules, PG&E owns the substation facilities at the Richmond refinery. Chevron receives electric service at higher-cost primary voltage levels.

In December 1987, PG&E filed A.87-12-009 under the Expedited Application Docket. PG&E sought Commission approval of an Electric Service Agreement reached with Chevron the previous month. The agreement was reached in lieu of Chevron constructing a 99 MW cogeneration plant at the refinery. By D.88-02-016, the Commission approved the contract subject to modifications in the floor price. The Commission stated that PG&E remained "at risk for any ratemaking treatment of the Agreement that the Commission later determines to be just and reasonable." (D.88-02-016, Conclusion of Law 2.)

In approving the contract, the Commission noted that the contract rates are subject to a floor which is based on PG&E's approved marginal costs for transmission voltage plus the Chevron-specific costs of transformation. (D.88-02-016, p. 3.) The substation-specific marginal cost component of the floor was implemented through an adder of $.00292 per kWh, which is multiplied by the annual kWh consumption. (D.88-02-016, p. 5.) That adder had been recommended by DRA in that proceeding. It was adopted by the Commission instead of a lower adder of $.00270 that was initially negotiated by PG&E and Chevron.

PG&E exercised its option to terminate the contract after Chevron announced a major expansion of its Richmond refinery. The new project rendered as no longer viable the originally planned cogeneration facility which was to be deferred by the contract. DRA agrees that such cancellation was appropriate.

The reasonableness of the Chevron contract was reviewed in last year's ECAC proceeding. One of the issues in that proceeding was the adequacy of the floor price of the contract. In D.90-12-128, the Commission expressed concern about the assumption of transmission level service in the floor since Chevron receives primary voltage service. The Commission concluded that PG&E had not persuasively demonstrated the reasonableness of the floor provisions. Despite that conclusion, however, the Commission held off disallowing any costs related to the floor revenues until the parties could expand on their positions in this proceeding. (D.90-12-128, p. 32.) Ordering Paragraph 3 of that decision provides that "[c]osts resulting from the failure to use primary service rates on setting the floor revenues for the Chevron contract shall remain uncollected, pending reconsideration in PG&E's next ECAC reasonableness review."

4.2 Discussion

4.2.1 Framing of the Chevron Floor Price Issue

The central issue before us is whether the floor price in the Chevron contract is inadequate because it is based on transmission level marginal costs, plus an adder of $.00292 per kWh, even though Chevron receives primary voltage service.

After reviewing the positions of the parties as they were refined during this proceeding, we find the issue can be stated even more specifically. DRA concedes that the adder reflects PG&E's Chevron-specific substation costs. Thus, more narrowly stated, the issue is whether the floor price is inadequate because it reflects the Chevron-specific costs of transformation rather than PG&E's higher system-average costs. DRA asserts that it is.

If we find that PG&E failed to prove that the floor is adequate, we must then determine whether PG&E has met its burden of proving that it acted reasonably at the time in negotiating the lower Chevron-specific price.

Finally, if the contract is found to be unreasonable, we must determine if any disallowance should be ordered for the 1988 record period. On this point the parties have agreed that if adopted system-average distribution costs are assumed, there was a negative contribution to margin of $695,877 for 1988. Under D.90-12-128, a disallowance of that amount would be ordered. On the other hand, PG&E has calculated a positive contribution to margin of $3,437,171 using Chevron-specific substation costs. DRA apparently accedes to this calculation but not the underlying assumption.

4.2.2 Scope of the Reasonableness Review

As a preliminary matter, we find it necessary to comment on another issue. PG&E implies that it is wrong for DRA to now reject the site-specific floor price methodology which it originally used, which the Commission provisionally accepted in D.88-02-016, and which DRA did not reject in last year's ECAC proceeding. PG&E complains that it is "particularly upsetting to PG&E to have DRA recommend continually tightening standards to be applied after-the-fact in this area." (Exhibit 63, p. DER-3.) On brief, PG&E calls DRA's position "punitive."

We find little foundation for PG&E's complaints. Our decision authorizing the Chevron contract was clear that PG&E remained at risk for possible disallowance in a future reasonableness review. (D.88-02-016, Conclusion of Law 2.) An after-the-fact review is exactly what we ordered and exactly what PG&E should have known it was subject to when we approved the contract in 1988. We did not say in that decision that DRA (and the ratepayers it represents) was at risk for any failure to raise issues during the course of that expedited proceeding, or for having raised the issues and taken the positions it did.

Any lingering doubt on PG&E's part about our intent, and the right of DRA to fully address the Chevron floor price issue should have been erased when we issued D.90-12-128. PG&E's criticisms are particularly ironic because we concluded in that decision that PG&E had failed to demonstrate the reasonableness of the floor price provisions. As already noted, we held off on ordering a disallowance at that time. Instead, we gave the parties a chance to expand on their positions. Now, having been given that opportunity to salvage its case, PG&E criticizes DRA for expanding on its position, which is exactly what we invited it to do.[2]

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2 In allowing parties to "expand" on their positions on the floor price, we did not restrict them to positions in harmony with earlier ones, or to old issues. As a hindsight observation, we note that it would have been preferable if DRA had raised the issue of system-average v. Chevron-specific costs when it first reviewed the contract for approval. But we do not fault DRA. Recognition of such issues is more likely to occur in an after-the-fact reasonableness review than in an expedited pre-approval matter.

PG&E appears to have forgotten that DRA's chance to revisit this issue exists only because PG&E itself was allowed to revisit it. We reject any contention or implication that, because of positions it has taken in earlier proceedings, DRA has waived its right to change its position and contest the floor price provisions of the Chevron contract.

4.3.3 Average v. Specific Distribution Costs

DRA witness Shovlain recommends that "[i]n negotiating a special contract rate, the utility should require the customer to at least cover the marginal cost of serving that customer. The difference between the marginal cost of serving a customer and the tariff rate is where the utility has room to negotiate a special rate." (Exhibit 66, p.5.) We concur with this criterion. It is consistent with our conclusion in the previous PG&E ECAC proceeding: "At a minimum, each customer on the system must pay the full marginal cost for the service it receives, whether or not it is being served under a special contract." (D.90-12-128, Conclusion of Law 7.)

DRA's criterion is met in this case. Even though the floor reflects the Chevron-specific cost rather than PG&E's higher system-average cost for distribution facilities, it still provides assurance that Chevron pays for all of the long-run marginal costs that PG&E incurs in providing service. We conclude that the contract's floor price meets our fundamental purpose in requiring special electric contracts to have such a floor, and that PG&E's other customers are not unduly subsidizing contract sales to Chevron.

But DRA points out that all other PG&E customers, whether under contracts or tariffs, pay the average distribution cost regardless of the specific cost of serving the customer. DRA argues that having a customer-specific floor price is unique and unfair to other PG&E customers, both those with special electric contracts and those who pay tariff rates.[3]

A special electric contract is the product of bilateral negotiations between the utility and one of its customers. That such a contract would contain a pricing provision which is not contained in any of the other nine contracts negotiated by PG&E (or in any of the utility's tariffs) is not surprising. We have prescribed several elements but not a uniform format for these contracts. It would be surprising if unique provisions could not be found among them.

At most, the presence of this floor price element suggests that within the permissible range between marginal costs and tariff rates, Chevron drove a harder bargain than other special electric contract customers did. Just as likely, the other special contracts could reasonably contain elements, in areas other than distribution costs, that are more favorable than those in the Chevron contract. In either case, the fact that Chevron is the only customer to pay site-specific distribution costs does not alone render the floor price inadequate for its intended purpose, or unfair.

If we were to determine that the Chevron contract is unfair and unacceptable because it contains unique and beneficial provisions not enjoyed by any other customer, it would be because

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3 Even though no customer but Chevron currently pays customer-specific T&D costs, the possibility exists that PG&E would be required to negotiate just such a provision in a special electric contract. At the time we established guidelines for accelerated approval of special contracts, we anticipated there would be contracts for incremental sales as well as those intended to avoid or defer bypass. Since contracts for incremental sales posed the possibility that, due to increased load, the utility would need to modify its T&D system, we provided that the price in this category of contracts "should recover an appropriate measure of these <u>site-specific</u> increased costs." (27 CPUC 2d 464, at 470; emphasis supplied.)

of a principle that no customer should pay a rate for any aspect of electric service which is below the rate paid by all other customers for the same service. While that principle would seem to be eminently fair, it is difficult to see how we could ever justify the existence of any special electric contracts if we were to adopt its use.

It is axiomatic that a lower rate enjoyed by a contract customer constitutes a disadvantage to customers paying tariff rates. It is our purpose to prevent any undue disadvantage. We indicated general approval of the use of special electric contracts in D.87-05-071. In doing so, we indicated our intent "to prevent unreasonable discrimination among customers and to ensure that other customers are not unreasonably disadvantaged by the contracts." (24 CPUC 2d 412, at 418.)

The floor price in the Chevron contract is designed to ensure that Chevron pays no less than the full marginal cost of its service. It does not also require Chevron to contribute to the cost of the kinds of distribution facilities required to serve most other PG&E customers. That is without question a disadvantage to all other customers, including those who are like Chevron in having lower-than-average site-specific costs. But we do not find the disadvantage to be unreasonable. The contract was negotiated to prevent bypass. If Chevron had bypassed the system, it would not have provided any contribution to the cost of distribution facilities. We conclude that the floor price provision is reasonable.

DRA also argues that because PG&E has not proved that it attempted to negotiate for system-average distribution costs, the contract does not provide assurance that PG&E has maximized its contribution to margin. We clearly want assurance that a utility maximizes the contribution to margin when it negotiates a contract. Whether it has done so is in general a legitimate and important issue in reviewing special contracts. But the purpose of the floor is to assure recovery of at least a minimum level of revenues, not to maximize contribution to margin. With respect to the Chevron contract, the sole issue that was left unresolved in D.90-12-128 was the adequacy of the floor price provision. DRA's argument does not relate to this issue.

Findings of Fact

1. In D.90-12-128, the Commission reviewed the reasonableness of PG&E's special contracts for 1988 and earlier periods, but deferred completion of its review of PG&E's contract with Chevron so that parties could expand on their positions on the adequacy of the floor price.

2. In D.90-12-128, the Commission concluded that the Unocal and Shell contracts were reasonable, but found that the contracts with Mills Hospital, Peninsula Hospital, Sequoia Hospital, Louisiana Pacific, Arco, USS Posco Industries, and Chevron did not guarantee collection of the adopted marginal costs of serving those customers.

3. A contract is unreasonable if it does not include adequate floor price provisions.

4. For each record period during which a contract yields a negative contribution to margin, the Commission will order a disallowance in that amount.

5. In D.90-12-128, the Commission concluded that PG&E should not be allowed future rate recovery for the portions of contracts that have been found to be unreasonable.

6. During the 1989 record period, there were ten special electric contracts between PG&E and its customers in effect: Mills Hospital, Peninsula Hospital, Sequoia Hospital, Louisiana Pacific, Arco, Unocal, Shell, USS Posco Industries, Chevron, and Texaco.

7. The contract with Texaco was the only new contract to become effective in 1989.

8. DRA concluded that the Texaco contract was executed in accordance with the Commission's guidelines and that the contract is reasonable.

9. PG&E's and DRA's calculations of each contract's contribution to margin for 1989 are in substantial agreement. Slight differences in their calculations are due to their different methods of accounting for summer and winter consumption during transitional billing periods.

10. DRA contends that its method of accounting for summer and winter consumption is more accurate.

11. For the ten contracts reviewed in this proceeding, DRA calculated the following contributions to margin for the 1989 record period:

Customer	CTM ($)
Mills Hospital	81,620
Peninsula Hospital	56,050
Sequoia Hospital	41,127
Louisiana Pacific	742,574
Arco - Fairfield	23,279
Arco - North Coles	(17,161)
Unocal	455,751
Shell	13,220,607
USS Posco Industries	4,620,673
Chevron	3,730,872
Texaco	170,283

12. The parties agree that a disallowance of $17,161 should be ordered in connection with the North Coles portion of the Arco contract with Arco due to the facility's negative contribution to margin in that amount.

13. D.90-12-128 provided that the issue of floor revenues for the Chevron contract shall be reconsidered in this reasonableness review.

14. PG&E owns the substation facilities at the Richmond refinery which allow Chevron to receive electric service at higher cost primary voltage levels.

15. The floor price in the Chevron contract reflects the adopted marginal costs of transmission voltage service plus an adder of $.00292 per kWh.

16. The adder of $.00292 per kWh reflects the cost incurred by PG&E for providing transformation facilities at the Richmond Refinery so that Chevron can receive primary voltage service.

17. The adder of $.00292 per kWh does not reflect or recover PG&E's adopted system-average cost for providing transformation and other distribution facilities.

18. If adopted system-average distribution costs are assumed, as recommended by DRA, the Chevron contract yielded a negative contribution to margin of $695,877 for 1988.

19. If Chevron-specific substation costs are assumed, the contract yielded a positive contribution to margin of $3,437,171 for 1988.

20. All PG&E electric customers but Chevron pay the average distribution cost regardless of the specific cost of serving the customer.

21. A special electric contract is the product of bilateral negotiations between the utility and one of its customers.

22. We have prescribed several elements, but not a uniform format for special contracts.

23. If we were to determine that the Chevron contract is unfair and unacceptable because it is unique, it would be because of a principle that no customer should pay a rate for electric service that is below the rate paid by all other customers.

24. The difference between the marginal cost of serving a customer and the tariff rate is where the utility has room to negotiate a special rate.

25. The Chevron contract floor price reasonably ensures that the customer pays at least all of the long-run marginal costs of service so that other customers are not unduly subsidizing the contract sales.

26. The Chevron contract floor price does not require Chevron to contribute to the cost of distribution facilities which are required for most other PG&E customers.

27. If Chevron had bypassed the system instead of entering into the contract, it would not have provided a contribution to the cost of distribution facilities which are required for most other PG&E customers.

28. It is not the purpose of the floor to maximize contribution to margin, and whether the Chevron contract does so is not an issue which was set for reconsideration in this proceeding.

29. DRA recommends that the final calculation of any disallowance include accrued interest.

<u>Conclusions of Law</u>

1. The Texaco contract is reasonable.

2. PG&E's administration of its special electric contracts was reasonable in 1989, except that the North Coles portion of the Arco contract did not yield a positive contribution to margin.

3. A disallowance of $17,161 plus interest should be ordered due to failure of the North Coles portion of the Arco contract to yield a positive contribution to margin during 1989.

4. DRA was entitled to fully address the Chevron floor price issue in this proceeding, and adopt positions different than those taken in earlier proceedings.

5. In regulating special electric contracts, it is one of our purposes to ensure that contract customers gain no undue advantage over other customers, and to ensure that other customers suffer no undue disadvantage.

6. Since the floor price provision in the Chevron contract is designed to ensure that Chevron pays no less than the full marginal cost of its service, the floor does not unreasonably disadvantage other customers.

7. Since the floor price provision in the Chevron contract is reasonable, DRA's recommended disallowance of $695,877 is not adopted.

8. This proceeding should remain open for consideration of Geysers Unit 15 issues.

ORDER

IT IS ORDERED that:

1. In connection with the North Coles portion of the Arco contract, $17,161 plus interest shall be disallowed in the form of a reduction in Pacific Gas and Electric Company's (PG&E) Electric Revenue Adjustment Mechanism account in conjunction with PG&E's next rate adjustment. Interest shall be calculated at the interest rate provided in Part B of the Preliminary Statement of PG&E's Electric Tariffs.

2. In all other respects, the costs set forth in PG&E's application as related to special electric contracts are reasonable and may be collected in rates.

3. Application 90-04-003 remains open for consideration of Geysers Unit 15 issues which have been consolidated with Investigation 90-02-043. This order supersedes Ordering Paragraph 3 of Decision 91-07-009.

This order becomes effective 30 days from today.

Dated November 6, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

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

Neal J. Shulman

NEAL J. SHULMAN, Executive Director

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