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Decision 92-09-022 September 2, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND
 ELECTRIC COMPANY and the CITY OF
 SANTA CLARA for an Order Pursuant
 to Section 851 of the Public
 Utilities Code Authorizing the
 Former to Convey an Interest in a
 Hydroelectric License for Project
 FERC No. 619 (Bucks Creek) in
 Accordance with the Terms of the
 Settlement of the Mokelumne River
 Project FERC No. 137 in an
 Agreement Dated March 8, 1990.

Application 90-06-007
 (Filed June 7, 1990)

(Electric) (U 39 E)

**OPINION ON PETITION FOR MODIFICATION OF DECISION
 90-12-123 TO RECOGNIZE A MINOR AMENDMENT TO THE
 UNDERLYING SETTLEMENT AGREEMENT**

Statement of Facts

Background

In 1925 the Federal Power Commission (FPC), predecessor of the Federal Energy Regulatory Commission (FERC), granted Pacific Gas and Electric Company (PG&E) a 50-year license under the Federal Power Act (FPA) for Hydroelectric Project No. 137 (the Mokelumne River Project).

As the 50-year license neared the end of its term, in 1972 PG&E filed a license renewal application for the Mokelumne project. In 1974 the City of Santa Clara (Santa Clara) filed a competing license application, claiming that the same municipal preference under the FPA applied to relicensing of existing projects as to licensing of new projects.

In 1986 Congress enacted the Electric Consumers Protection Act of 1986 (ECPA) which amended the FPA to specify and clarify that municipal applicants have preference only during initial hydroelectric projects licensing proceedings. But as to specific pending disputed cases, including the Mokelumne Project relicensing, the ECPA established certain procedures. Section 10 of these ECPA procedures provides that if the contesting parties elect to use the settlement procedure by which the competitor party withdraws, the parties must negotiate compensation for the competitors, and if the parties cannot agree on the compensation, the FERC will determine it.

Had PG&E and Santa Clara not reached an agreement, Santa Clara's compensation claim of \$41,194,499 would have been left to FERC to decide under Section 10 of ECPA. By avoiding cost of litigated settlement by FERC, a significant ratepayer benefit resulted in and of itself.

In 1987 PG&E elected to be governed by the provisions of Section 10 of ECPA. Santa Clara then accepted the election and withdrew its competing application. After extensive negotiations culminating in a Memorandum of Understanding, PG&E and Santa Clara on March 18, 1990 executed a Settlement Agreement subject to approval by FERC and this Commission.

The PG&E-Santa Clara Settlement Agreement

By this Agreement PG&E will design and have built for Santa Clara a new 20.51 megawatt (MW) hydroelectric plant (Grizzly). PG&E will convey the plant to Santa Clara subject to a reversionary future interest in PG&E.¹ The target date for

¹ Upon notice, and at specified dates, PG&E could terminate Santa Clara's interest and acquire Grizzly, compensating Santa Clara an amount determined under the Agreement. There were four dates, subject to adjustment, with the fourth not subject to adjustment on or after January 1, 2024.

completion is January 1, 1994. A 1988 FERC order amended the Bucks Creek Project license so that Santa Clara could jointly hold the license, thereby providing for Santa Clara ownership and operation.

Santa Clara is to finance and pay for the new hydroelectric plant (estimated initially to cost approximately \$60 million net of financing costs²), with the parties to share any cost overruns up to 10 percent of the Final Project Cost Target if the Actual Project Cost exceeds the Final Project Cost Target. Overruns beyond are to be paid by PG&E. Costs incurred for certain FERC license requirements (called Additional License Related Costs) are to be paid by Santa Clara up to a \$2.607 million limit.

By the Agreement, and after FERC approval of the Agreement, PG&E made a nonrefundable payment of \$1 million to Santa Clara. In addition, PG&E is to sell Santa Clara certain amounts of electric power beginning February 20, 1990, at prices and terms specified in the Agreement and broken down into four time periods.

Application 90-06-007 Leading to Decision 90-12-123

In 1990 PG&E and Santa Clara filed Application (A.) 90-06-007, seeking authority to transfer to Santa Clara certain operating and other rights under their Settlement Agreement, and (1) authority to include, subject to review, the Settlement Costs in PG&E's 1993 General Rate Case, (2) authority to later recover construction costs variances, and (3) a nondeferrability finding for Grizzly re future resource need determinations in Biennial Resource Plan Update proceedings.

² The Initial Project Cost Target (currently \$57.36 million) will be subject to adjustment for the actual prices of contracts awarded, and for costs resulting from delays prior to award of principal contracts to the extent such delays result from Santa Clara's actions, regulatory approval delays, or Force Majeure. These adjustments will develop the Final Project Cost Target.

While not opposing the application the Energy Resources Branch of the Division of Ratepayer Advocates (DRA) proposed, and PG&E accepted, certain conditions which were incorporated in Decision (D.) 90-12-123. This decision found the transfer of rights sought to be "fair, just and reasonable to the parties and to PG&E's ratepayers", as well as "not adverse to the public interest". The parties in this ex parte decision were authorized to make the conveyance and to carryout the terms and provisions of their Settlement Agreement, subject to the DRA conditions.

Later Developments

Central to the PG&E-Santa Clara Settlement Agreement were the financing and ownership by Santa Clara of the Grizzly hydroelectric plant. In the latter months of 1991, the parties solicited and received construction bids for the plant. From these it was determined that the plant could not be constructed within the range of costs anticipated when their agreement was initially entered upon.³

Santa Clara had an option (the Cost Off-Ramp) to terminate development of Grizzly as a result of these unexpected construction cost increases, but both parties would have lost. In addition, there were significant ratepayer benefits to PG&E reaching an amendment to the Original Settlement Agreement as opposed to Santa Clara exercising its Cost Off-Ramp alternative. A Santa Clara termination would have required PG&E to return construction funds already advanced, and would have lost a valuable power resource capable of producing 62.7 Gigawatthours of energy in average rainfall years, although termination would also have

³ Based on actual construction bids, the Final Project Cost Target was 27 percent higher than the Initial Project Cost Target.

extended the power sale period.⁴ The unwelcome cost increase development forced the parties to a prompt decision on whether or not to proceed. The Sierra Nevada construction seasons are short and there was the risk of further cost escalation in delay. Both parties being desirous of preserving the benefits anticipated from construction, they negotiated, and on August 8, 1991, executed an amendment to their earlier Agreement, an amendment FERC approved on September 11, 1991.

The Amendment the Commission is Asked to Sanction

The amendment increases revenues to PG&E by providing that the capacity sales shall be 27.66 MW each month throughout the Power Sale period which is also extended through year 2003, instead of the previous provision of 27.66 MW until Grizzly operated commercially, and thereafter 10 MW each month until December 31, 1995. Before, the capacity pricing remained at \$9 per Kilowatt month (kW-month) through the period. Under the amendment, while retaining that \$9 per kW-month pricing through 1995, beginning in 1996 it increases by \$.50 per kW-month each year until it reaches \$11 per kW-month in 1999 where it will remain through 2003, unless PG&E has to acquire new resources to supply Santa Clara. In this latter event, the capacity price changes to PG&E's then Partial Requirements Power Capacity Rates, using the methods specified by the parties' Interconnection Agreement.

Previously energy was to be priced at 26.90 mills per kilowatt hour (kWh) in 1990, and escalated according to a preset formula over the period of the sale. The sale also had certain

4 While Santa Clara's withdrawal from Grizzly would not have terminated the license Settlement itself, it would have extended the high margin power sale to Santa Clara by PG&E. But overall, ratepayer benefits would have been reduced due to refund requirements, and loss of the ultimate opportunity to acquire Grizzly by the Settlement Agreement alternative.

minimum monthly energy purchase requirements which reached a 40 percent capacity factor level in the final years. Under the amendment energy will continue to be priced at the original formula through 1997; thereafter, 1998 through 2003, energy will be priced at Partial Requirements Power energy rates under the Interconnection Agreement between the parties.

The existing Settlement Agreement accepted by D.90-12-123 provides that PG&E may, upon notice, on the 15th, 20th, and 25th anniversary dates after Grizzly begins operations, and on or after January 1, 2024,⁵ terminate Santa Clara's interest and acquire Grizzly, compensating the City for any unamortized City interest. The amendment we are here asked to recognize to the underlying Settlement Agreement authorized by D.90-12-123 removes the December 31, 2023 limitation and provides that PG&E shall not exercise the first reverter date. The purpose of the change is to permit Santa Clara a longer period to enjoy the benefits of Grizzly and to recover the increased construction costs.

Under the Settlement Agreement sanctioned by D.90-12-123, the parties are to share construction cost overruns up to 10 percent of the Final Project Cost Target, with PG&E to pay for any overruns in excess of that 10 percent. The amendment adds \$2 million of contingency funds to be borne by Santa Clara to the Final Project Cost Target.

⁵ The first 3 dates were subject to adjustment: 1) in the event of lower levels of energy production results, 2) for delay costs incurred from Santa Clara actions, delays in regulatory approvals, or Force Majeure after the award of the principal construction contracts, 3) if the Actual Project Costs exceed the Initial Project Cost Target, and 4) if Grizzly development ceases or catastrophic damage is incurred and Santa Clara elects not to rebuild. However, these first three reverter dates could not be delayed beyond December 31, 2023.

There is also a \$2.607 million limit on costs associated with certain FERC licensing requirements. Under the Settlement Agreement, PG&E is to bear all costs in excess of that amount. The amendment transfers \$607,000 of engineering costs already incurred from PG&E developed design modifications against this account while keeping the \$2,607,000 limit. However, the PG&E modifications are expected to reduce the construction costs that could be charged to this account.

The Present Petition to Modify D.90-12-123

On October 11, 1991, PG&E and Santa Clara filed their present petition to request modification of D.90-12-123 to reflect, recognize, and approve their June 11, 1991 amendment to the underlying March 8, 1990 Settlement Agreement in D.90-12-123. With this amendment, Appendix A to the petition, they assert that the Settlement Agreement will continue to satisfy all of Santa Clara's claims under Section 10 of ECPA for compensation. The parties further claim that with this amendment the Settlement Agreement will continue to be fair, just, and reasonable both to the parties and to PG&E's ratepayers. The parties assert their belief that the public interest would best be served by prompt implementation of the terms of the Settlement Agreement as amended.

In addition, PG&E asks that the Commission recognize that the August 6, 1991 amendment to the original Settlement Agreement does not alter any of the reasons which led to Finding No. 20 in D.90-12-123 that the future acquisition by PG&E of Grizzly would constitute a nondeferrable resource for purposes of determining resource needs in future Biennial Resource Plan Update proceedings.

In support of this request, PG&E asserts that apart from Grizzly being an improvement proposed in the context of relicensing proceedings at FERC, and thus to be treated as generically

unavoidable by qualifying facilities (QFs),⁶ it meets the project-specific four part nondeferrability tests of PG&E's Biennial Resource Plan Update proceeding,⁷ in that:

1. PG&E's economic analysis shows the future acquisition to be cost effective even though it understates the benefits (only 16 years of PG&E ownership benefits are considered with all acquisition costs being amortized in that period, and the likelihood that Grizzly will operate longer).
2. Among Grizzly's unique aspects are that it will be a peaking resource,⁸ and peakers are nondeferrable by QFs,⁹ it will be an existing resource at PG&E option to acquire with no development risk, and is a hydro relicense improvement.
3. While operational and economic benefits are difficult to quantify, Grizzly is a hydro project with no fuel costs, and being acquired at a depreciated price, will be very low cost

6 Ordering Paragraph 13 in Re Pacific Gas and Electric Company (1988) 27 CPUC 2d 559, 586 provided that unlike other generation resources, improvements to hydroelectric projects under FERC relicensing were to be treated as generically unavoidable by QFs.

7 Re Pacific Gas and Electric Company (1986) 21 CPUC 2d 340, 380 recognized that specific projects may have such complex impacts on the utility's existing system that it would be difficult to avoid them on the basis of the long-run standard offer because their system impacts would still be desirable or be impossible for QFs to provide. Therefore, utilities are permitted to make a showing of nondeferrability on a project-specific basis which must: (1) establish cost effectiveness, (2) set forth aspects justifying a finding of nondeferrability, (3) quantify the economic and operational benefits of such aspects, and (4) describe the impact of attempted deferral through use of "adders" and standard offer contracts.

8 Id. at 380.

9 Id. note 6.

peaking resource with no development risk premium when acquired by PG&E for the ratepayers to pay for. Grizzly is an addition to the existing 57.5 MW Bucks Creek project and will extend the license period at least 14 years, thereby protecting the project from takeover by competing applicants.

4. Addition of "adders" to Final Standard Offer 4 (FSO4) contracts to defer the Grizzly peaking resource is not feasible, and even if the FSO4 could defer a peaker, QFs would have no economic incentive to enter into a contract. "Adders" reflecting Grizzly's unique benefits would have negative values. Scheduled for peak hours, Grizzly will have greater operating flexibility than unit specific or combination of QFs that are either energy limited or are so process constrained that they operate in a baseload mode. As an existing resource when acquired by PG&E, there is lower construction cost/delay risk than any unit specific or combination of QFs.

Notice of the Petition to Modify D.90-12-123 appeared in the Commission's Daily Calendar of October 22, 1991. No protests have been received. Originally assigned to Administrative Law Judge (ALJ) Donald B. Jarvis, upon his retirement in December 1991, the matter on January 14, 1992 was reassigned to ALJ John B. Weiss. In the absence of any contravention ALJ Weiss has proceeded ex parte.

Discussion

Rule 43 of the Commission's Rules of Practice and Procedure inter alia provides for petitions for modification of a Commission decision. The rule requires that reasons to justify the relief sought must be indicated, and limits such petitions to proposing minor changes in the subject decision.

PG&E and Santa Clara justify their present petition to modify D.90-12-123 on the grounds that construction costs far in excess of the amounts initially contemplated by the parties forced certain minor changes which had to be made in the Settlement

Agreement authorized to be implemented by that decision. Against the backdrop of short mountain construction seasons and the risk of future cost escalation in delay, the parties were forced to a quick decision whether or not to proceed with development of Grizzly. While termination of development would not have canceled the Settlement Agreement, it would have significantly reduced the value of the Settlement Agreement to PG&E's ratepayers, and Santa Clara could have terminated by exercising its Cost Off-Ramp rights because of the added costs. In the negotiations that followed a compromise amendment resulted, one commensurate with the additional risks and costs of proceeding with development but one that also essentially preserves the benefits each party anticipated to themselves and for the ratepayers from the earlier Settlement Agreement. The amendment provides that Santa Clara will not exercise the Cost Off-Ramp and that development of Grizzly will proceed. As amended, the Settlement Agreement will remain in full satisfaction of all Santa Clara claims under ECPA for compensation. The parties indicate that it constitutes a mutually satisfactory compensation arrangement that is consistent with the provisions of the FPA.

PG&E has analyzed the benefits and costs to the ratepayers resulting from this amendment to the D.90-12-123 authorized Settlement Agreement, using the same methodology and assumption that were used in the original Mokelumne Settlement economic analysis provided the Commission on June 26, 1990. PG&E's analysis uses several scenarios projecting the value of power to the PG&E system and incorporates the terms of the amendment to the

Settlement Agreement.¹⁰ It examines the ratepayer impacts in completing Grizzly with subsequent reverter to PG&E, as well as the impacts that would result were PG&E to terminate as unduly burdensome or Santa Clara to exercise its Cost Off-Ramp. Under these scenarios, benefits to the ratepayers are the highest in the situation, as is contemplated to be followed with Commission sanction, where Grizzly is developed pursuant to the Settlement Agreement as amended, with a subsequent reverter to PG&E. The primary reasons for this result are the continuation of high margin power sales to Santa Clara, avoidance of any necessity to refund Santa Clara's construction funds, and the PG&E future ownership of Grizzly.

In addition, by adoption of the amendment and completion of Grizzly, the period of PG&E's Bucks Creek project FERC license will be extended at least 14 years; Grizzly will be a renewable resource with no air emissions, and when acquired by PG&E there will be no development risk so that ratepayers will pay no development risk premium; and as Grizzly's operations will be under PG&E control there will be no impact in other PG&E Feather River Canyon hydroelectric facilities' operations.

With these assertions in mind, the Commission recognizes that significant ratepayer benefits will result from amendment of the Settlement Agreement of March 8, 1990, as opposed to a Santa Clara exercise of the Cost Off-Ramp available to the City under the unamended Settlement Agreement. D.90-12-123, pursuant to Public Utilities Code § 851, authorized PG&E to convey to Santa Clara

¹⁰ While PG&E, currently engaged in negotiations on other hydroelectric relicensing disputes, considers its economic analysis to be confidential, and that public disclosure would be harmful to the utility and its ratemakers, at the specific request of the ALJ it did provide the latter with a copy of this analysis pursuant to provisions of PU Code § 583.

certain rights in a hydroelectric license under the Settlement Agreement entered between the parties resolving a relicensing dispute over the Mokelumne River Project. Accordingly, the Commission concludes that this existing authorization, subject to the conditions stated in D.90-12-123, to transfer an interest in the Bucks Creek license to Santa Clara as provided for under the amendment to the Settlement Agreement, is in the best interests of the ratepayers and should be continued. And, after consideration of PG&E's assertions, we agree that the amendment does not alter any of the reasons which led us to Ordering Paragraph 6 in D.90-12-123, and conclude that the Commission will continue to consider PG&E's future acquisition of Grizzly as being that of a nondeferrable resource.

Findings of Fact

1. In 1974 Santa Clara contested PG&E's relicensing application for PG&E's Mokelumne River Project.
2. Pursuant to provisions of the ECPA which amended the FPA and set up procedures to resolve relicensing conflicts, and to settle Santa Clara's claim for compensation under ECPA, PG&E and Santa Clara entered upon a Settlement Agreement by which PG&E would build at Santa Clara's expense, and convey to Santa Clara, a hydroelectric plant (Grizzly) on the Mokelumne River Project, subject to a reversionary future interest in PG&E.
3. By D.90-12-123, PG&E was granted authorization by the Commission to convey to Santa Clara an interest in PG&E's license with reference to Grizzly and to carryout the terms and provisions of the Settlement Agreement subject to express conditions set forth in D.90-12-123.
4. D.90-12-123 further provided that in the event PG&E acquired Grizzly at a future time, that future acquisition would be treated as a nondeferrable resource for the purpose of determining resource needs in future Biennial Resource Plan Update proceedings.

5. In the event, construction cost bids on Grizzly substantially exceeded the range of costs anticipated by PG&E and Santa Clara, forcing reconsideration, and leading to adoption of an amendment to the Settlement Agreement.

6. By the amendment, Santa Clara agrees to proceed with development of Grizzly, revisions are made to the Power Sale provisions of the Settlement Agreement extending power sales and making changes for capacity sales, price and rate, minimum monthly energy purchase obligations are removed, changes are made to reverter dates provisions so that Santa Clara has a longer period to enjoy the benefits of Grizzly and to recover increased construction costs, and provisions are made for additional construction costs.

7. The amendment serves to retain the substantial benefit under the Settlement Agreement of avoided litigation costs, and continues to be full satisfaction of all Santa Clara claims for compensation under ECPA.

8. PG&E's analysis of benefits to ratepayers under various scenarios indicates that benefits are highest under the provisions of the Settlement Agreement as amended, with Grizzly being constructed for Santa Clara with later reversion to PG&E, principally because of continued high margin power sales to Santa Clara, avoidance of any necessity to refund construction funds, and PG&E future ownership of Grizzly.

9. The amendment does not alter any of the reasons which led the Commission to adopt Ordering Paragraph 6 in D.90-12-123 which provides that in the event PG&E acquired Grizzly, such future acquisition would be treated as a nondeferrable resource for the purpose of determining resource need in future Biennial Resource Plan Update proceedings.

10. A public hearing is not necessary in this matter.

11. The public interest would best be served by the prompt implementation of the terms of the amended Settlement Agreement.

Conclusions of Law

1. The petition for modification of D.90-12-123 should be granted.
2. The decision which follows should be made effective immediately.

ORDER

IT IS ORDERED that:

1. The October 11, 1991 petition of Pacific Gas and Electric Company (PG&E) and the City of Santa Clara to the Commission to modify Decision (D.) 90-12-123 to effect minor amendments to the Settlement Agreement underlying D.90-12-123, as contained in Appendix A to the petition, is granted.
2. The existing authority to carryout the terms and provisions of the Settlement Agreement, subject to the amendments provided for herein, is continued.
3. The existing authorization to PG&E pursuant to Public Utilities (PU) Code § 851 to transfer to Santa Clara an interest in the Bucks Creek Project is continued.

4. The Commission will continue to maintain PG&E's future acquisition of the Bucks Creek Project as being a nondeferrable resource for the purposes of determining resources needs in future Biennial Resource Plan Update proceedings.

This order is effective today.

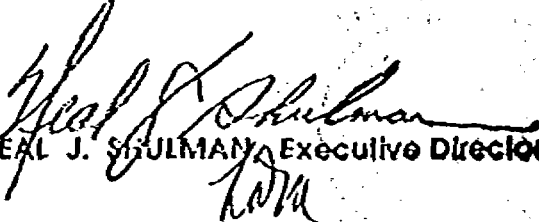
Dated September 2, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President

JOHN B. OHANIAN
NORMAN D. SHUMWAY
Commissioners

Commissioner Patricia M. Eckert,
being necessarily absent, did
not participate.

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


NEAL J. SCHULMAN, Executive Director