Decision 82 07 021 JUL 7 1982 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for authority to assume liabilities as guarantor on certain facility bonds to be issued on behalf of California Power & Light Corporation.

Application 61117
(Filed December 8, 1981)

O P I N I O N

Summary

This decision authorizes the Pacific Gas and Electric Company (PG&E) to become a guarantor of certain bonds issued for California Power & Light Corporation (CP&L). The bonds are required to finance the construction of a 49,990 kW biomass-fueled electric generating plant in Madera County, California.

We grant PG&E's request that any risk compensation it receives from CP&L shall not be recognized for ratemaking purposes. This below-the-line treatment also extends to any guaranty payments PG&E may make as a guarantor of CP&L's bonds. Both the benefits and the risks of this guaranty agreement will be borne entirely by PG&E's shareholders and will not be shared in any part by PG&E's customers. ✓

Background

CP&L plans to build a 49,990 kW biomass-fueled electric generating plant and to sell the power generated at the plant to PG&E at PG&E's standard price offer for small power producers. The facility will be located in Madera County and will use forest products and agricultural wastes as boiler fuel to generate steam for two turbine generators. CP&L estimates that the facility will cost $125 million and that it will start operating in mid-1984.

CP&L plans to finance the facility partly through the issuance of revenue bonds by the California Pollution Control Financing Authority under a trust indenture. Under a guaranty agreement, attached to the application as Appendix B, PG&E will make guaranty payments to the trustee of the trust indenture in an amount which the debt service on the bonds exceeds the amount received by CP&L under a power sales agreement with PG&E. PG&E's obligation to make such guaranty payments may not exceed $733,333 each month. Any such payments made by PG&E are to be repaid by CP&L. The guaranty agreement and the corresponding power sales agreement have 25-year terms from the date the facility is demonstrated to PG&E's satisfaction.

As compensation to PG&E for the risk of making guaranty payments, CP&L will pay PG&E a negotiated percentage of PG&E's avoided costs. PG&E requests that any risk compensation received from CP&L should not be considered in any of our ratemaking proceedings. PG&E asserts that the obligation to make guaranty payments on behalf of CP&L is not a part of PG&E's utility business, but is a financing agreement with another company. Accordingly, PG&E maintains that any monetary benefits from the guaranty agreement should not be passed through to PG&E's customers.

Application (A.) 61117 is the second application filed by PG&E for this particular facility. The first application, A.60077, was taken off calendar after the issuance of a proposed report from the assigned Commissioner which would have denied the application. Denial was recommended because PG&E's showing in A.60077 was deficient in a number of areas, leading to the conclusion that the Power Sales Agreement then negotiated between PG&E and CP&L posed unquantified and therefore unreasonable risks for PG&E's customers.

Rather than resurrect A.60077, PG&E instead chose to restructure its participation in CP&L's project and filed this application, A.61117. The crucial change is that PG&E no longer asks that its customers bear any of the technical or financial risks presented by the facility. PG&E's customers will pay only for delivered power from CP&L; PG&E's shareholders now will bear all responsibility for the guaranty payments which in the prior application, A.60077, would have been shouldered by PG&E's customers.

PG&E has requested ex parte processing of this application. The Commission staff has reviewed A.61117 and has not requested a public hearing. We will dispose of A.61117 on an ex parte basis since a public hearing is not necessary.

Issues

A.61117 presents the following questions:

1. Should PG&E be authorized to assume liability as guarantor of the bonds issued on behalf of CP&L for construction of a biomass electric generating plant?
2. Does PG&E's requested participation in the financing of CP&L's project present any unacceptable risks for its customers or its shareholders?
3. Are PG&E's shareholders entitled to all of the benefits accruing from the guaranty agreement with CP&L?
4. Does PG&E's proposed below-the-line treatment of this transaction create a possibility of cross-subsidization of an unregulated venture by its regulated operations?
5. May the Commission ignore for ratemaking purposes the financial consequences of a guaranty agreement it expressly approves with an order?

We will attempt to answer each of these questions in the following discussion.

Discussion

Public Utilities (PU) Code § 830 provides that:

> "No public utility shall assume any obligation or liability as guarantor, endorser, surety, or otherwise in respect of the securities of any other person, firm, or corporation, when such securities are payable at periods of more than 12 months after the date thereof, without having first secured from the commission an order authorizing it so to do. Every such assumption made other than in accordance with the order of the commission authorizing it is void."

PG&E has requested approval of its guaranty agreement with CP&L to comply with the requirements of § 830. Although PG&E further asks that its shareholders should bear all the risks and benefits of this agreement, we find that PG&E's participation in the financing of this so-called "qualifying facility" under the Public Utility Regulatory Policies Act must be examined. By aiding the financing of CP&L's biomass project, PG&E is diversifying into an unregulated venture which may affect its regulated utility business. Our concern here is for the protection of PG&E's financial integrity as well as the potential for cross-subsidization by a regulated entity of an unregulated venture. Thus, we first must determine that the proposed participation does not create unacceptable financial risks for PG&E. In addition, we must preclude any cross-subsidization and the related anticompetitive effects of utility behavior which might result.

PG&E contends in its application that the risk presented by the guaranty agreement is minimized by the following protective provisions:

1. CP&L is required to finance the facility with a minimum of 25% equity contributions.

2. CP&L must supply an operating and maintenance fund of at least $1 million throughout the life of the guaranty agreement.
3. CP&L must contract for a sufficient fuel supply to operate at a 65% capacity for at least ten years.
4. The boilers for the facility must be designed to burn oil, gas, and synfuels in addition to biomass fuel.
5. CP&L must obtain adequate insurance for the facility.
6. CP&L may not sell or grant security interests in the facility, except to PG&E, but may execute subordinate liens up to $3 million.
7. No acceleration of the debt service payments may be made which would affect PG&E.
8. CP&L must demonstrate the facility to PG&E's satisfaction before PG&E's obligation to make guaranty payments arises.
9. CP&L must relinquish control of the facility to PG&E if PG&E makes guaranty payments for six consecutive months; PG&E is entitled to keep the facility's net revenues while it is under PG&E's control.
10. If CP&L does not repay PG&E the guaranty payments made by PG&E within 18 months after PG&E has taken control, CP&L must convey the entire facility to PG&E.

In PG&E's view, the above protective provisions reduce the risk that PG&E will have to make guaranty payments or that payments will be made and not recovered by PG&E. For our purposes, the provisions also ensure that PG&E's financial integrity will not be jeopardized by the agreement. We are unable to ascertain the actual risk that PG&E faces, but we are confident that the

risk presented by the guaranty agreement should not in the future impair PG&E's ability to raise capital, its bond rating, interest coverage, or other key financial indicators. We are not concerned with the actual risk or the amount of risk compensation PG&E will receive. PG&E and CP&L have freely negotiated the risk compensation provision. Furthermore, PG&E's customers should not be affected by the level of the guaranty payments or the risk compensation payments. Our inquiry here is limited to the impact of the agreement on PG&E's financial health since this transaction will not be directly considered in any of our ratemaking proceedings.

We note that PG&E's application and the guaranty agreement are silent on the ratemaking treatment of PG&E's guaranty payments or reimbursement by CP&L of those payments. Clearly, PG&E's shareholders are responsible for any guaranty payments unless PG&E requests and receives recovery of the payments through an energy cost adjustment clause (ECAC) or other offset proceeding. We emphasize, as PG&E has done in the application and the agreement only for the risk compensation payments, that PG&E's shareholders are assuming the obligation to make guaranty payments. PG&E should not be permitted to seek recovery of any guaranty payments in ECAC or any other ratemaking proceeding. PG&E's shareholders are entitled to receive the benefits of the risk compensation payments only if they also assume the responsibility for all guaranty payments.

Even though the guaranty and risk compensation payments are given below-the-line treatment, there remains a possibility that PG&E's regulated operations may subsidize this unregulated venture. This could occur since PG&E so far has not formed a separate subsidiary to handle its diversification into unregulated ventures like CP&L's facility. Until PG&E's regulated and non-regulated activities are legally divided, we will instruct PG&E to

separately account for its nonregulated expenses. In this case, any expenses associated with the guaranty, i.e. employee time, administrative overhead, and materials, should be paid by the shareholders and not by the customers. Although the amount of these expenses should be relatively small, we will order PG&E to separately account for those expenses and not to seek recovery of those expenses from its customers.

If PG&E continues to participate in unregulated risks and returns of small power producers, as we expect it will, investors' perception of the utility and its financial strength very likely will be affected. Although we declare here that the measured or tangible benefits and risks of this guaranty agreement will not be recognized in any ratemaking proceedings, any complete evaluation of PG&E's overall financial picture by the public and by this Commission will doubtless consider both its regulated and its unregulated activities.

Findings of Fact

1. PG&E and CP&L have negotiated a guaranty agreement which obligates PG&E to assume liability for certain facility bonds.

2. The guaranty agreement contains protective provisions which ensure that PG&E's financial integrity is not jeopardized.

3. PG&E requests below-the-line treatment of any risk compensation payments it receives from CP&L.

4. Below-the-line treatment is appropriate only if PG&E's shareholders assume the obligation for making guaranty payments along with the right to claim the risk compensation payments.

5. PG&E's participation in the financing of CP&L's facility is not directly related to its utility business.

6. Any expenses incurred by PG&E because of the guaranty agreement should be paid by its shareholders and not its customers.

Conclusions of Law

1. The guaranty agreement between PG&E and CP&L is reasonable and prudent; PG&E should be authorized under PU Code § 830 to assume liabilities as guarantor under the agreement.

2. PG&E should not be permitted to seek recovery of any guaranty payments in any ratemaking proceeding; any risk compensation received by PG&E should not be considered in any ratemaking proceeding.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized under PU Code § 830 to assume the obligations and liabilities as guarantor on the facility bonds described in this application.

2. PG&E shall not seek recovery of any guaranty payments in any ratemaking proceeding; risk compensation described in the application shall not be considered in any ratemaking proceeding.

3. PG&E shall separately account for all expenses arising from the guaranty agreement and shall not seek recovery of those expenses in any ratemaking proceeding.

4. Within sixty days from the effective date of this decision, PG&E shall file with the Revenue Requirements Division pro forma entries showing the manner in which it would record compensation for risk guaranty payments, any guaranty payments, and expenses related to the guaranty.

This order becomes effective 30 days from today.

Dated July 7, 1982, at San Francisco, California.

RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

Commissioner John E. Bryson, being necessarily absent, did not participate.

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

Joseph E. Bodovitz, Executive Director

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Background

CP&L plans to build a 49,990 kW biomass-fueled electric generating plant and to sell the power generated at the plant to PG&E at PG&E's standard price offer for small power producers. The facility will be located in Madera County and will use forest products and agricultural wastes as boiler fuel to generate steam for two turbine generators. CP&L estimates that the facility will cost $125 million and that it will start operating in mid-1984.

separately account for its nonregulated expenses. In this case, any expenses associated with the guaranty, i.e. employee time, administrative overhead, and materials, should be paid by the shareholders and not by the customers. Although the amount of these expenses should be relatively small, we will order PG&E to separately account for those expenses and not to seek recovery of those expenses from its customers.

~~Despite the foregoing, we recognize that until PG&E spins off its nonregulated activities into a separate and distinct subsidiary, its nonutility business cannot be totally divorced from its utility business or completely shielded from our review of utility business in regulatory proceedings.~~ If PG&E continues to participate in unregulated risks and returns of small power producers, as we expect it will, investors' perception of the utility and its financial strength very likely will be affected. Although we declare here that the measured or tangible benefits and risks of this guaranty agreement will not be recognized in any ratemaking proceedings, any complete evaluation of PG&E's overall financial picture by the public and by this Commission will doubtless consider both its regulated and its unregulated activities.

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3. PG&E requests below-the-line treatment of any risk compensation payments it receives from CP&L.

4. Below-the-line treatment is appropriate only if PG&E's shareholders assume the obligation for making guaranty payments along with the right to claim the risk compensation payments.

3. PG&E shall separately account for all expenses arising from the guaranty payment and shall not seek recovery of those expenses in any ratemaking proceeding.

This order becomes effective 30 days from today.

Dated JUL 7 1982, at San Francisco, California.

RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
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Commissioners

Commissioner John E. Bryson, being necessarily absent, did not participate.