Decision 82 09 023 SEP 8 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SAN DIEGO GAS & ELECTRIC COMPANY for Authority to Increase its Electric Rates and Charges, to Establish an Annual Energy Rate and to Make Certain Other Rate Changes in Accordance with the Energy Cost Adjustment Clause as Modified by Decision 92496.	Application 60865 (Filed September 4, 1981; amended November 6, 1981)

O P I N I O N

In early 1982 it became apparent that obligations of San Diego Gas & Electric Company (SDG&E) under its oil supply contracts would provide for delivery of oil significantly in excess of its requirements. By Decision (D.) 82-04-073 issued April 12, 1982, the Commission directed SDG&E to show cause why the Commission should not require SDG&E to suspend or reduce deliveries of residual fuel oil scheduled under existing contracts with its suppliers, Hawaiian Independent Refinery, Inc. (HIRI) and Tesoro. Among other things, the Commission ordered SDG&E to file a pleading which would include a detailed cost/benefit analysis of suspending deliveries as contrasted with continuing deliveries of fuel oil under the currently effective contracts as well as a discussion of all matters of fact and policy regarding fuel oil procurement which SDG&E considered relevant to a possible reduction or suspension of deliveries by force majeure.

On April 19, 1982, SDG&E filed its initial response to the Commission's order to show cause, which sets forth SDG&E's version of the facts and the applicable law. The filing indicated that the oil excess was now anticipated to be 10,000 barrels per day, nearly three

times what had previously been predicted. Furthermore, SDG&E indicated that it was in the midst of negotiations with Tesoro for a renegotiated oil purchase contract which could supply oil in excess of SDG&E's oil requirements at the cost of gas, thus negating the financial loss to the ratepayers from burning oil in lieu of gas. As the negotiations were not complete, SDG&E requested that the Commission undertake no immediate action to order a reduction of deliveries. SDG&E also set forth the legal objections to such a Commission order raised by its legal advisors and by refiners, HIRI and Tesoro.

Subsequently, SDG&E and Tesoro reached tentative agreement on a new contract amendment. SDG&E advised the Commission of this agreement through a Supplemental Response to the Data Request filed with the Commission on July 29, 1982.

The essential provisions of the tentative agreement are as follows:

> Commencing October 1, 1982 all oil deliveries under the SDG&E-Tesoro contract will be suspended for the remainder of the contract. There is no extension of the original agreement, which expires on December 31, 1983.
>
> SDG&E agrees to pay Tesoro an underlift fee of $6.55 per barrel for oil not taken under the agreement, payable monthly.
>
> SDG&E retains an option, exercisable on 45-days' notice, to purchase up to 6,000 barrels per day of LSFO and thus avoid underlift payments on a barrel-for-barrel basis.
>
> SDG&E agrees to allow Tesoro to store residual fuel oil in its storage tanks if Tesoro so requests, for a storage charge of 20 cents a month per barrel plus a one time 5-cent put through charge per barrel.
>
> SDG&E and Tesoro agree to modify the force majeure clause of the contract to remove governmental intervention of specific description from the set of conditions which excuse performance.

> The agreement is contingent upon Commission termination of the Order to Show Cause proceeding by September 1, 1982, and at SDG&E's option, upon Commission approval of the above contract provisions.

SDG&E further stated in its Supplemental Response that the net ratepayer savings as a result of this agreement would range from $27.3 million to $57 million, with a most likely savings of $42.5 million.

The Commission concludes, after a review of the proposed SDG&E-Tesoro agreement, that implementation of this suspension of the remainder of the Tesoro contract constitutes good cause not to order a reduction in oil deliveries to SDG&E. However, the Commission by this order makes no finding as to the reasonableness of the suspension agreement itself or the charges to be incurred by SDG&E as a result of the suspension agreement. The reasonableness of these consequences for the utility must undergo a thorough review by the Commission staff in the usual procedure -- in the course of an annual ECAC review. To clarify the ratemaking treatment to be afforded SDG&E, we will permit consideration of the suspension agreement and the underlift charges associated with it in the forthcoming SDG&E annual review ECAC, A.82-08-014, currently set for hearings in late September 1982. We note that SDG&E has included portions of the expenses resulting from the suspension agreement in its application for the forthcoming ECAC review. The Commission staff is directed to review the proposed suspension agreement and provide a recommendation as to whether any or all of the expenses SDG&E will incur through underlifts or other charges as a result of the suspension agreement should be passed on in rates to SDG&E's customers.

Such a review by the staff will focus on the reasonableness of the underlift charges contained in the suspension agreement and their inclusion in Annual Energy Rates (AER) for the forthcoming year. Underlifts, like oil sale losses, are normally estimated on a forward-looking annual basis. However, we note that one provision of the proposed suspension agreement requires different treatment of underlifts.

We note SDG&E's stated intention to terminate oil deliveries from Tesoro as of October 1, 1982. Recovery of underlifts for the month of October is not contemplated by current AER rates, which are set to remain in effect until November 1, 1982. However, in SDG&E's last annual review ECAC decison, the Commission authorized a specific departure from the usual AER treatment of oil sale losses incurred by SDG&E. The Commission stated in D.82-04-115, issued April 28, 1982:

> "With respect to the treatment of oil sale losses, we will accept SDG&E's recommendation and continue treatment of such expenses in the ECAC balancing account for now. This action is taken solely to reflect the uncertainty surrounding the issue of SDG&E's scheduled fuel oil deliveries and the prospect that SDG&E may accomplish certain reductions in its current fuel oil contracts. We note that D.82-04-073 issued April 12, 1982 directed SDG&E to show cause why the Commission should not require SDG&E to suspend or reduce deliveries of residual fuel oil scheduled under its existing contracts with HIRI and Tesoro.
>
> "By maintaining treatment of fuel oil sale losses in ECAC we seek to avoid compromising or limiting SDG&E's negotiating posture with HIRI and Tesoro as well as to avoid prejudging the outcome of our order to show cause. While we authorized continued ECAC balancing account treatment of fuel oil sale losses, we will place SDG&E on notice that any request for allowance of such expenses in the November ECAC will be subjected to very rigorous Commission scrutiny." (D.82-04-115, pp. 30-31.)

With the negotiation of the Tesoro suspension agreement, and the information provided by SDG&E and the Commission staff regarding SDG&E's forecasted fuel oil inventory levels for the upcoming year, it is apparent that SDG&E will not likely face the need to sell excess oil during the remainder of the current AER period, that is, until November 1, 1982. The underlifts for the month of October represent the primary cost of SDG&E's efforts to reduce inventory during that time, a cost which was not reasonably foreseeable when the AER rate was set earlier in 1982. Accordingly, to be consistent with the intent of our earlier decision, and to permit SDG&E the opportunity to request recovery of the October underlift charges in rates, the Commission hereby authorizes SDG&E to place in the ECAC balancing account underlift charges incurred as a result of the Tesoro suspension agreement between the commencement of the agreement on October 1, 1982 and the Commission's issuance of a final decision in the annual review ECAC, Application 82-08-014. This authorization is made for the specific purpose of allowing the underlift charges so booked to be scrutinized by the staff in the same fashion as the remainder of the costs incurred by SDG&E as a result of the Tesoro suspension agreement. The Commission does not intend by this order to prejudge the reasonableness of all or a part of the underlift charges to be incurred in October 1982.

We also specifically find that this order represents no determination as to the reasonableness of the SDG&E-HIRI oil contract, which will be examined in the forthcoming annual ECAC review according to normal procedures.

Finally, we note that the Commission does not, by this decision, rule upon any of the jurisdictional issues raised by SDG&E in this proceeding, with respect to the Commission's authority to issue an order to reduce or suspend oil deliveries.

This matter was held from Agenda 2621 and inadvertently was not included on Agenda 2622.

This order should become effective immediately.

Findings of Fact

1. SDG&E and Tesoro have reached tentative agreement on an amendment to their fuel oil supply agreement.

2. Under the proposed amended contract, beginning October 1, 1982, all oil deliveries under the SDG&E-Tesoro contract will be suspended for the remainder of the contract; further, SDG&E agrees to pay Tesoro an underlift fee of $6.55 per barrel of oil not taken under the agreement.

3. The amended agreement could result in net ratepayer savings ranging from $27.3 million to $57 million over the next fifteen months.

4. This order represents no determination as to the reasonableness of the SDG&E-HIRI oil contract which will be examined in SDG&E's upcoming ECAC.

5. In view of the proposed underlift charges to be paid under the new SDG&E-Tesoro agreement, oil sale losses will be less likely to occur than previously estimated.

Conclusions of Law

1. The amended agreement does constitute good cause not to order a reduction in oil deliveries to SDG&E.

2. The order to show cause directed by D.82-04-073 should be terminated.

3. SDG&E should include in its forthcoming annual review ECAC application (A.82-08-014) a complete showing regarding the amended agreement and the costs it imposes on SDG&E.

4. The Commission's right to examine the reasonableness of the charges incurred as a result of the renegotiated agreement in SDG&E's upcoming ECAC annual reasonableness review is specifically reserved.

5. As a general proposition, recovery of underlift charges paid by SDG&E to Tesoro should be sought through SDG&E's AER.

6. Inasmuch as SDG&E is less likely to incur oil sale losses as a result of the amended agreement, and the current AER will not include underlift charges incurred in October 1982 pursuant to the

amended agreement, SDG&E should be allowed to include in the ECAC balancing account for consideration in A.82-08-014 all underlift charges incurred as a result of the amended agreement from October 1, 1982 until a final decision in A.82-08-014 is rendered.

7. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The order to show cause directed by D.82-04-073 is terminated.

2. San Diego Gas & Electric Company (SDG&E) is authorized to place underlift expenses incurred as a result of the amended agreement with Tesoro between October 1, 1982 and the date of the final decision in A.82-08-014 in the ECAC balancing account for consideration in said proceeding.

3. The reasonableness of charges incurred by SDG&E as a result of its renegotiated agreement with Tesoro and its contract with Hawaiian Independent Refinery, Inc. will be examined in the upcoming ECAC, A.82-08-014.

This order is effective today.

Dated September 8, 1982, at San Francisco, California.

JOHN E. BRYSON
President
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

I dissent.

/s/ RICHARD D. GRAVELLE
Commissioner

I dissent.

/s/ LEONARD M. GRIMES, JR.
Commissioner

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

Joseph E. Bodovitz, Executive Director

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A.60865
D.82-09-023

RICHARD D. GRAVELLE, Commissioner and
LEONARD M. GRIMES, JR., Commissioner, Dissenting:

We dissent.

While today's decision in this matter may appear on the surface to be a simple rescission of the Order to Show Cause (D.82-04-073) issued April 12, 1982, and deferral of the determination of reasonableness for ratemaking purposes of SDG&E's action in renegotiating its Tesoro contract to A.82-08-014, it is, in fact, a much more critical policy decision. It eliminates any possibility of relieving SDG&E and its customers from onerous oil supply contract provisions.

The Order to Show Cause which we issued to SDG&E in April provided us the procedural vehicle to order suspension of all oil deliveries pursuant to the force majeure provisions of both the Tesoro and HIRI contracts. Such action on our part would have constituted a major governmental policy decision that would let utilities, oil suppliers and consumers know that the California Public Utilities Commission would no longer tolerate pass through to the utility ratepayer of oil costs which were not needed for electric generation. Such action on our part would have left the oil supplier with the option to negotiate a more reasonable arrangement with the utility or, at its option, to commence litigation against the utility. While the utility would be the nominal defendant in such a lawsuit, the real defendant would be the utility customer, the individuals, businesses, cities and towns of our state, who would be asked to pay for oil unneeded for electrical generation.

While it is clear that the renegotiated contract between SDG&E and Tesoro relieves the utility and its ratepayers from some of the preceding contract obligations, it is also clear that it does so at a cost of approximately $35 million annually through calendar 1983. It is also reasonably clear, as far as we can determine, that

had we ordered suspension of oil takes, and had Tesoro decided to litigate rather than negotiate further and, had SDG&E lost the litigation without mitigation of damages, that the additional exposure to SDG&E and possibly its ratepayers would have been in the neighborhood of another $17 to $20 million.

We strongly believe that Tesoro would have been motivated to negotiate further rather than sue, that had a lawsuit been its choice SDG&E and its ratepayers would have had a strong chance of winning, and that even had they lost, mitigation measures would reduce damages well below the $17 to $20 million range. Given our belief that the utility and its ratepayers would have prevailed on the merits in a lawsuit, we believe the prudent action on our part would have been to order suspension of all oil takes at this time. In other words, we think it was a prudent risk, using the Tesoro contract renegotiation as an example, to risk paying $17-$20 million in possible additional damages in order to avoid certain payment of $35 million in underlift fees.

An underlying but essential policy issue that pervades this decision is the current day efficacy of long term oil supply contracts for utilities. While the new Tesoro contract terminates at the end of 1983 other utility oil supply contracts do not and some have even been recently extended. Experience should have taught this Commission that the so-called advantage of a long term assured supply contract in the face of a supply crisis is purely illusory. HIRI suspended supply to SDG&E as recently as the Iranian crisis. Oil suppliers, acting pursuant to federal allocation directives, reduced supplies to California airlines in the late 1970's when this Commission regulated such airlines, necessitating reductions in service.

In 1982 we should realize that the burdens of the long term contracts do not match up to their benefits to utility and ratepayer. We would be better served by ordering, to the extent contract force

majeure provisions allow, a termination of the long term contracts and an order to our California utilities to develop, for our approval, a method of pooling resources to purchase LSFO as needed for generation by all California electric utilities either on a spot market basis or short term (one year) basis.

We are concerned that today's decision, while saving some dollars, may unnecessarily cost our electric utilities and their ratepayers many millions of dollars over the long term.

RICHARD D. GRAVELLE, Commissioner

LEONARD M. GRIMES, Jr., Commissioner

San Francisco, California
September 8, 1982

times what had previously been predicted. Furthermore, SDG&E indicated that it was in the midst of negotiations with Tesoro for a renegotiated oil purchase contract which could supply oil in excess of SDG&E's oil requirements at the cost of gas, thus negating the financial loss to the ratepayers from burning oil in lieu of gas. As the negotiations were not complete, SDG&E requested that the Commission undertake no immediate action to order a reduction of deliveries. SDG&E also set forth the legal objections to such a Commission order raised by its legal advisors and by refiners, HIRI and Tesoro.

Subsequently, SDG&E and Tesoro reached tentative agreement on a new contract amendment. SDG&E advised the Commission of this agreement through a Supplemental Response to the Data Request filed with the Commission on July 29, 1982.

The essential provisions of the tentative agreement are as follows:

> Commencing October 1, all oil deliveries under the SDG&E-Tesoro contract will be suspended for the remainder of the contract. There is no extension of the original agreement, which expires on December 31, 1983.
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> SDG&E agrees to pay Tesoro an underlift fee of $6.55 per barrel for oil not taken under the agreement, payable monthly.
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> SDG&E retains an option, exercisable on 45-days' notice, to purchase up to 6,000 barrels per day of LSFO and thus avoid underlift payments on a barrel-for-barrel basis.
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> SDG&E agrees to allow Tesoro to store residual fuel oil in its storage tanks if Tesoro so requests, for a storage charge of 20 cents a month per barrel plus a one time 5 cent put through charge per barrel.
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> SDG&E and Tesoro agree to modify the force majeure clause of the contract to remove governmental intervention of specific description from the set of conditions which excuse performance.

> SDG&E retains an option, exercisable on 45-days' notice, to purchase up to 6,000 barrels per day of LSFO and thus avoid underlift payments on a barrel-for-barrel basis.
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> SDG&E and Tesoro agree to modify the force majeure clause of the contract to remove governmental intervention of specific description from the set of conditions which excuse performance.
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> The agreement is contingent upon Commission termination of the Order to Show Cause proceeding by September 1, 1982, and at SDG&E's option, upon Commission approval of the above contract provisions.

SDG&E further stated in its Supplemental Response that the net ratepayer savings as a result of this agreement would range from $27.3 to $57 million, with a most likely savings of $42.5 million.

The Commission concludes, after a review of the proposed SDG&E-Tesoro agreement, that implementation of this suspension of the remainder of the Tesoro contract constitutes good cause not to order a reduction in oil deliveries to SDG&E. However, the Commission by this order makes no finding as to the reasonableness of the suspension agreement itself or the charges to be incurred by SDG&E as a result of the suspension agreement. The reasonableness of these consequences for the utility must undergo

a thorough review by the Commission staff in the usual procedure -- in the course of an annual ECAC review. To clarify the ratemaking treatment to be afforded SDG&E, we will permit consideration of the suspension agreement and the underlift charges associated with it in the forthcoming SDG&E annual review ECAC, A.82-08-014, currently set for hearings in late September 1982. We note that SDG&E has included portions of the expenses resulting from the suspension agreement in its application for the forthcoming ECAC review. The Commission staff is directed to review the proposed suspension agreement and provide a recommendation as to whether any or all of the expenses SDG&E will incur through underlifts or other charges as a result of the suspension agreement should be passed on in rates to SDG&E's customers.

Such a review by the staff will focus on the reasonableness of the underlift charges contained in the suspension agreement and their inclusion in Annual Energy Rates (AER) for the forthcoming year. Underlifts, like oil sale losses, are normally estimated on a forward looking annual basis. However, we note that one provision of the proposed suspension agreement requires different treatment of underlifts.

We note SDG&E's stated intention to terminate oil deliveries from Tesoro as of October 1, 1982. Recovery of underlifts for the month of October is not contemplated by current AER rates, which are set to remain in effect until November 1, 1982. However, in SDG&E's last annual review ECAC decison, the Commission authorized a specific departure from the usual AER treatment of oil sale losses incurred by SDG&E. The Commission stated in D. 82-04-115, issued April 28, 1982:

> With respect to the treatment of oil sale losses, we will accept SDG&E's recommendation and continue treatment of such expenses in the ECAC balancing account for now. This action is taken solely to reflect the uncertainty surrounding the issue of SDG&E's scheduled fuel

> oil deliveries and the prospect that SDG&E may accomplish certain reductions in its current fuel oil contracts. We note that D.82-04-073 issued April 12, 1982 directed SDG&E to show cause why the Commission should not require SDG&E to suspend or reduce deliveries of residual fuel oil scheduled under its existing contracts with HIRI and Tesoro.
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> By maintaining treatment of fuel oil sale losses in ECAC we seek to avoid compromising or limiting SDG&E's negotiating posture with HIRI and Tesoro as well as to avoid prejudging the outcome of our order to show cause. While we authorized continued ECAC balancing account treatment of fuel oil sale losses, we will place SDG&E on notice that any request for allowance of such expenses in the November ECAC will be subjected to very rigorous Commission scrutiny. (D.82-04-115, pp. 30-31.)

With the negotiation of the Tesoro suspension agreement, and the information provided by SDG&E and the Commission staff regarding SDG&E's forecasted fuel oil inventory levels for the upcoming year, it is apparent that SDG&E will not likely face the need to sell excess oil during the remainder of the current AER period, that is, until November 1, 1982. The underlifts for the month of October represent the primary cost of SDG&E's efforts to reduce inventory during that time, a cost which was not reasonably foreseeable when the AER rate was set earlier in 1982. Accordingly, to be consistent with the intent of our earlier decision, and to permit SDG&E the opportunity to request recovery of the October underlift charges in rates, the Commission hereby authorizes SDG&E to place in the ECAC balancing account underlift charges incurred as a result of the Tesoro suspension agreement between the commencement of the agreement on October 1, 1982 and the Commission's issuance of a final decision in the annual review ECAC, Application 82-08-014. This authorization is made for the specific purpose of allowing the underlift charges so booked to be scrutinized by the staff in the same fashion as the remainder of the costs incurred by SDG&E as a result of the Tesoro suspension agreement. The Commission does not intend by this order to

prejudge the reasonableness of all or a part of the underlift charges to be incurred in October 1982.

We also specifically find that this order represents no determination as to the reasonableness of the SDG&E-HIRI oil contract, which will be examined in the forthcoming annual ECAC review according to normal procedures.

Finally, we note that the Commission does not, by this decision, rule upon any of the jurisdictional issues raised by SDG&E in this proceeding, with respect to the Commission's authority to issue an order to reduce or suspend oil deliveries.

This order ~~is~~ should be effective immediately.

Findings of Fact

1. SDG&E and Tesoro have reached tentative agreement on an amendment to their fuel oil supply agreement.

2. Under the proposed amended contract, beginning October 1, 1982, all oil deliveries under the SDG&E-Tesoro contract will be suspended for the remainder of the contract; further, SDG&E agrees to pay Tesoro an underlift fee of $6.55 per barrel of oil not taken under the agreement.

3. The amended agreement could result in net ratepayer savings ranging from $27.3 million to $57 million over the next fifteen months.

4. This order represents no determination as to the reasonableness of the SDG&E-HIRI oil contract which will be examined in SDG&E's upcoming ECAC.

5. In view of the proposed underlift charges to be paid under the new SDG&E-Tesoro agreement, oil sale losses will be less likely to occur than previously estimated.

Conclusions of Law

1. The amended agreement does constitute good cause not to order a reduction in oil deliveries to SDG&E.

2. The order to show cause directed by D.82-04-073 should be terminated.

3. SDG&E should include in its forthcoming annual review ECAC application (A.82-08-014) a complete showing regarding the amended agreement and the costs it imposes on SDG&E.

4. The Commission's right to examine the reasonableness of the charges incurred as a result of the renegotiated agreement in SDG&E's upcoming ECAC annual reasonableness review is specifically reserved.

5. As a general proposition, recovery of underlift charges paid by SDG&E to Tesoro should be sought through SDG&E's AER.

6. Inasmuch as SDG&E is less likely to incur oil sale losses as a result of the amended agreement, and the current AER will not include underlift charges incurred in October 1982 pursuant to the amended agreement, SDG&E should be allowed to include in the ECAC balancing account for consideration in A.82-08-014 all underlift charges incurred as a result of the amended agreement from October 1, 1982 until a final decision in A.82-08-014 is rendered.

7. This order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. The order to show cause directed by D.82-04-072 is ~~rescinded~~ terminated.

2. San Diego Gas & Electric Company (SDG&E) is authorized to place underlift expenses incurred as a result of the amended agreement with Tesoro between October 1, 1982 and the date of the final decision in A.82-08-014 in the ECAC balancing account for consideration in said proceeding.

3. The reasonableness of charges incurred by SDG&E as a result of its renegotiated agreement with Tesoro and its contract with Hawaiian Independent Refinery, Inc. will be examined in the upcoming ECAC, A.82-08-014.

This order is effective today.

Dated SEP 8 1982, at San Francisco, California.

JOHN E. BRYSON
President
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

I dissent.

RICHARD D. GRAVELLE Commissioner

I dissent.

LEONARD M. GRIMES, JR. Commissioner