

Decision 83 95 038 MAY 4 1983

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Second Application of PACIFIC
GAS AND ELECTRIC COMPANY for
Approval of Certain Standard
Offers Pursuant to Decision
No. 82-01-103 in Order
Instituting Rulemaking No. 2.

Application 82-04-44
(Filed April 21, 1982)

In the Matter of the Application
of SOUTHERN CALIFORNIA EDISON
COMPANY for an Order by the
California Public Utilities
Commission Directing Edison
to Purchase Power from
Qualifying Facilities Based
on a Standard Offer for Firm
Capacity and Energy Based on
Long-Run Marginal Costs
(OIR-2).

Application 82-04-46
(Filed April 21, 1982)

In the Matter of the Application
of SAN DIEGO GAS & ELECTRIC
COMPANY for an Order by the
California Public Utilities
Commission Directing SDG&E to
Purchase Power from Qualifying
Facilities Based on Standard
Offers and to Make Certain
Changes or Additions to its
Tariff Affecting Purchases from
Qualifying Facilities.

Application 82-04-47
(Filed April 21, 1982)

INTERIM OPINION ON PROCEDURAL GUIDELINES

Introduction

The purpose of this decision is to establish a procedure to help resolve issues surrounding the "long-term resource plan based offer" (Standard Offer No. 5) ordered by the Commission in Decision (D.) 82-01-103, Order Instituting Rulemaking (OIR) 2, (January 21, 1982).

D.82-01-103 established comprehensive guidelines for sales of electricity from small power producers to utilities. The utilities were ordered to file five standard offers, each with different terms and conditions. The first four offers were all derived from short-run avoided cost methodologies that are conceptually well understood, even though many difficult details needed to be worked out in compliance hearings.

The conceptual approach for development of the offer was not established for the long-run resource plan offer, and D.82-01-103 ordered utilities to make proposals for our review. After reviewing those offers, it became clear that evidentiary compliance hearings would lead to protracted conceptual cross-examination on how to pay small power producers entering long-term contracts for their value in deferring new utility capacity. Rather than starting with the utility proposals, we decided it would be preferable to define the alternatives, present some tentative proposals, and receive comments from parties. With this approach, parties' general positions could be better understood, and we hoped to establish a framework before going into detailed compliance hearings on specific utility offers filed within that framework.

So, we issued on November 18, 1982 a Report and Request for Comments (Report) which presented issues relating to Standard Offer No. 5 and tentatively proposed a framework for such an offer. The Report concluded that an interim offer should be based on a five-year forecast of utility projected short-run marginal costs, followed by prices in future years based on the energy and capacity costs of a new coal plant. The Report also proposed that payments escalate over the life of the contract to avoid complex termination requirements and that the small power producer should be given flexibility about the output commitment it will take for future years. We asked parties to comment.

Responses by Parties to Commission Report

By January 31, 1983 the Commission received comments on the Report from 18 interested parties addressing both substantive and procedural issues. The comments were uniformly helpful. The comments included constructive criticisms of the Report and imaginative alternative frameworks for a long-run offer. The Commission was presented good information on how to achieve a workable and useful long-term offer.

Most importantly, the comments indicated a broad consensus about the need to achieve the underlying purpose of the Standard Offer No. 5 which is to provide greater price certainty and to value the small power producers' facilities consistently with utility resources. Pacific Gas and Electric Company (PG&E), for example, while disagreeing with much in the Commission's Report, strongly endorsed the Report's purpose:

"It has become apparent that the currently available standard offers do not meet the needs of all QFs. One of the major reasons for this is the high degree of future price uncertainty in these offers which adversely affects the ability of some projects to obtain financing.

. . . A well designed standard offer, which mitigates the uncertainty, is consistent with avoided cost principles, and balances ratepayer and QF risk would also be desirable." (PG&E comments, page 1.)

PG&E offers a new proposal for a framework to provide greater pricing certainty for small power producers. Similarly, Southern California Edison Company (SCE) and San Diego Gas & Electric Company (SDG&E) express general accord with the purposes of the Report and make new proposals for a standard offer framework.

Parties representing small power producers also agree that a greater pricing certainty is necessary. Many point out that different facilities have different needs and possibly more than one long-term price offer should be available.

In addition to providing useful substantive information, the comments also suggest procedures for resolving this matter. There was significant difference of opinion among parties on procedure.

In our Report, we tentatively concluded "that resolution of conceptual and policy issues on what methodology is to be selected for the long-term offer does not require factual evidence, but can instead be more effectively decided through written comments and possibly oral presentations." (Commission Report, page 6.) We envisioned the conceptual and policy issues being resolved through a rulemaking-type procedure, while the details of an actual offer would be resolved in subsequent compliance hearings.

PG&E and SDG&E strongly disagree with this procedure. They argue that evidentiary hearings are necessary before the conceptual issues in the standard offer can be resolved. PG&E argues that fairness and due process require that hearings be held. "[I]t would

be highly undesirable to resolve these very complex issues without the benefit of evidentiary hearings." SDG&E expresses similar concerns, arguing that the proposed format by the Commission would lead to lengthy compliance hearings and uncertainty about the details of any final order.

SCE also suggests that evidentiary hearings are necessary:

"Edison believes that these hearings can be handled expeditiously, and without undue delay, if the scope of such hearings is clearly defined. While we certainly agree that the public interest is not served by delay, neither is it served by an incomplete examination of the complex issues surrounding this topic, possibly resulting in the selection of a costing methodology that inaccurately values QF power to utilities and their ratepayers. Edison suggests that, upon receipt and examination of the comments submitted by the various utilities and interested parties, the Commission should submit a 'summary report' which delineates both the various proposals presented and the issues to be examined in an evidentiary hearing."

Many of the other parties commented on procedure. Pacific Energy Resources (Pacific Energy) agreed to hearings. While stating that the Commission report provides a helpful framework, it argues that:

"[I]ssues raised in this report can be only fully explored by means of hearings before the Commission. At such time each interested party and each utility can present alternative methods of implementing the proposals outlined by the Commission in its report and can present alternative proposals for consideration."
(Comments of Pacific Energy, page 10.)

The hearings contemplated by Pacific Energy appear to involve direct presentations to the Commission rather than substantial cross-examination.

Occidental Geothermal, Inc. suggests that "further cooperative exchange of ideas is necessary before QFs can formulate any comprehensive proposal." (Comments of Occidental Geothermal, Inc., page 6.) To that end, it proposes a sequence of workshops, evidentiary hearings on issues relating to project risks, briefs, a decision to order utilities to file an offer, followed by compliance hearings and a decision. Ultrasystems Incorporated also suggests evidentiary hearings on risk-related issues.

California Manufacturers Association basically supports our proposed procedure. It suggests workshops, briefs, followed by a Commission decision, followed by compliance hearings on utility filings. California Independent Energy Producers also supports our proposal.

Natural Resources Defense Council agreed that evidentiary hearings are not necessary, but suggested parties should have the opportunity to comment on other parties' comments. Similarly, the California Energy Commission suggests another round of comments after this Commission issues a more detailed rule.

1. Procedural Course and Guidelines

The decision on how to proceed with these consolidated matters is important. We are aware that some QFs are anxious to see this standard offer resolved soon in order to decide whether to begin projects. Delay on completing this offer could arrest QF development. On the other hand, it is also important to explore these issues to assure that ratepayers' interests are protected.

There are two major alternatives developed by parties. One proposed by utilities would be to hold evidentiary hearings on all of these issues, followed by an order, followed by compliance hearings on utilities' offers. The second general proposal would be the receipt of further written and oral comments, followed by compliance hearings.

Either approach would be overly time consuming and would not necessarily serve the interests of parties. The comments of parties convince us that a long-term standard offer is highly complex, involving avoided cost methodology, performance requirements, and termination penalties. The issues will not be quickly resolved under either procedure. Because of the complexity, we also are not certain that a Commission-ordered standard offer will best meet the needs of parties. It is evident that there are many possible standard offers which could be developed that are consistent with avoided cost pricing principles.

We have decided, therefore, to use a different procedure to resolve this matter before holding any formal evidentiary hearings. We have decided to hold a negotiating conference to give parties an opportunity to work together toward a methodology for an interim long-term standard offer[s]. We noted earlier that there is widespread consensus among parties on the immediate need for the long-term standard offer to provide greater pricing certainty and to reflect the value of QFs in deferring new utility resources. While there are many ideas on how to translate this concept into an offer, we think with the mutual objective of a timely decision in mind, parties can reach an accord.

The negotiating conference, to be held before any formal hearings on the long-term offers, is intended to achieve three things: (1) establish an offer[s] which can be filed by utilities at least on an interim basis which will be supported by the parties; (2) an agreement on a proposal clearly identifying issues, if any, which require further proceedings; and (3) a better understanding by all parties of each other's positions on this complex matter. This, in turn, will lead to sharper definition of issues for any formal

hearings in the future. The Commission, of course, will review and approve any interim offer, and address any proposals for additional proceedings. However, with substantial agreement among parties, we expect to be able to act more expeditiously.

The negotiating conference is a new procedure for the Commission. It should take place in a spirit of cooperation, not of adversarial posturing. Parties should come prepared for an intensive period of education, negotiation, and problem solving. Parties will all benefit by reaching an accord because an interim offer may then be quickly put in place.

We expect the negotiating conference to reach substantial agreement within one month after it commences in the middle of May. We will make as much time available during that month as is necessary for parties to work out an agreement. A tentative schedule for the conference will be presented by the administrative law judge (ALJ) on the first day of the conference. Parties will have an opportunity to review and discuss it. We expect the schedule to permit a thorough presentation of positions on the major issues by parties, followed by analysis, followed by negotiations to settle on an offer. The dynamics of the conference will, of course, depend upon the nature of the issues that need to be discussed.

The negotiating conference will begin on May 23, 1983, and will last not longer than four weeks, with regularly scheduled meetings. Parties should send representatives who can commit extensive time to this process and who can present positions and negotiate. We encourage QFs with similar interests to join and work together. We also encourage parties not only to send technical staff, but also be represented by those who can negotiate and make decisions. The staff will be represented by the Director of the Utilities Division, who will be supported by technical staff and staff counsel.

When the negotiating conference ends, the ALJ will issue a ruling which sets the time in which the three applicant utilities shall amend their applications with new standard offers. After a reasonable time for all parties to review and evaluate the amended standard offers, we will schedule a prehearing conference to evaluate the need for evidentiary hearings and, if they are required, their scope.

In order to encourage open participation at the negotiating conference, we will order that Rule 50 of our Rules of Practice and Procedure shall apply.¹ That will encourage a free and candid exchange of information, ideas, and alternatives.

2. Issues for Resolution

The comments in response to our Report provided many useful suggestions on defining a long-term contract and highlighted the issues that need to be settled. Two broad issues arise. First, what costs are avoided by long-term QF contracts? Second, a related and workable pricing mechanism, with appropriate contract terms and conditions, must be established to pay the QFs for their contribution of providing electricity to avoid those costs. The nature of these payments may vary depending upon the conditions of operation agreed upon by QFs. Generally, the utilities devoted more attention to the first issue of costing, while QFs generally devoted more to the latter issue of pricing.

¹ Rule 50 provides as follows: "(Rule 50) Facts Disclosed Privileged. Facts disclosed in prehearing conferences are privileged. Except by agreement, they shall not be used against participating parties, before the Commission or elsewhere, unless proved by evidence other than that employed in disclosing such facts."

a. Costing Methodologies

The utilities generally support use of projected short-run avoided costs (i.e., marginal running costs plus shortage value) for use in defining a long-run offer. Utilities assert that the criteria for determining whether a utility would add a new resource depends on whether the capital and operating costs of the proposed resource is less than the projected short-run avoided cost. Resources are added until the two are equal according to the rule of economic dispatch.

We agree that methodologies using projected short-run avoided costs and using the costs of new resources should produce the same results in theory. However, the problem is translating projected costs into QF prices. The utilities contend that the short-run methodology can be used. The Commission's Report found that a coal plant would be a simpler proxy. Other parties expressed mixed views on the issue.

We expect this issue to be developed fully in the negotiating conference. Parties should have the opportunity to demonstrate clearly how to derive avoided cost numbers from their marginal cost methodology. A major criteria for consideration will be workability as well as theoretical validity. We are looking for results. We expect the negotiating conference to develop a consensus methodology that fairly reflects the long-term value of QF power that can be readily implemented through pricing.

b. Pricing

It is apparent from the comments that developing an avoided cost estimate represents only part of the problem of developing a standard offer. Equally difficult is translating those costs into a contract with prices, terms, and conditions.

QFs have different views on what the contracts should be like. Some QF representatives, particularly those with cogeneration facilities, are interested in fixing incremental heat rates in a contract, but not fixing total fuel prices, since a cogenerator's fuel price may fluctuate with the rates of serving gas utilities. Others would like more pricing certainty, including in some cases, levelized payments. Another area of difference involves performance requirements. Some QFs can produce reliably based on very stringent performance standards, others produce intermittently and seek a more flexible standard.

These differences explain why QFs want an array of standard offers; however, we must caution the parties that trying to devise a number of standard offers to accommodate all QF situations - and which do not result in favoring some QF technologies over others - will result in tremendous complexity and, of course, attendant delay.

We welcome some variety of long-term offer options, but we stress that all variations must be consistent with avoided cost principles. If levelized payments are proposed, for all or part of the contract term, we expect corresponding proposals to mitigate potential loss to the ratepayer resulting from nonperformance or overpayment.

c. Resolution of Issues Resulting
From the Negotiating Conference

We expect that most of the issues can be resolved in the negotiating conference to permit an agreement on an offer that utilities should file on an interim basis. The agreement should include both a conceptual framework and a means of deriving specific prices. We do not expect that parties will waive their rights to

further proceedings in this matter. The long-term offer methodology is evolving, and it may be useful to further analyze the question later. Therefore, in addition to a standard long-term offer, we solicit a consensus from parties on a procedure for further analysis of the long-term offers.

All parties should come to the negotiating conference with the list of issues which they see needing to be resolved, and should be prepared with proposals for resolution of issues. Staff will prepare and submit a comprehensive listing based on the comments for review already filed by parties. We expect the proposals to be offered with a spirit of compromise. Everyone will have the opportunity to present their proposals at the negotiating conference and make suggestions for improvements of other proposals.

INTERIM ORDER

IT IS ORDERED that:

1. A negotiating conference to be presided over by ALJ Alderson shall be held on May 23, 1983, at 9:30 a.m. at Hastings College of the Law, 198 McAllister Street, Room K, San Francisco. This conference shall continue over a four-week period, with the schedule to be set by the ALJ. It will not be reported by the Commission's Reporter, and the use of material disclosed during the conference will be governed by Rule 50 of the Commission's Rules of Practice and Procedure.

2. After the negotiating conference ends, the ALJ shall issue a ruling providing a time limit within which the applicants shall amend their applications with revised standard offers. Thereafter, a prehearing conference shall be scheduled to assess the need for hearings and define their scope.

3. This order shall also be served on the applicants and the parties served with D.82-12-120 in Application 82-03-26 et al.

This order is effective today.

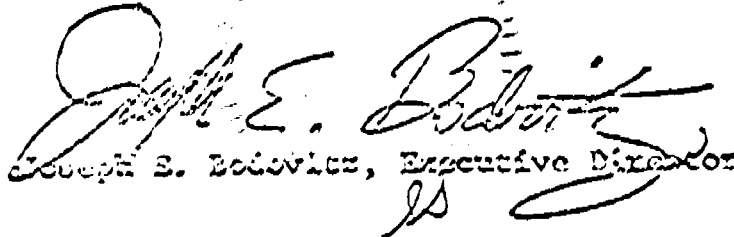
Dated MAY 4 1983 , at San Francisco, California.

I abstain.

FRISCILLA C. GREW, Commissioner

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
DONALD VIAL
Commissioners

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


Joseph S. Bolovitz, Executive Director



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