ALJ/CMW/tcg

Mailed

AUG 0 7 1997

Decision 97-08-061 August 1, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS & ELECTRIC COMPANY, for Authority to Adjust its Electric Rates Effective January 1, 1995, and for Commission Order Finding that Electric Operations During the Reasonableness Review Period from January 1, 1993 to December 31, 1993, Were Prudent.	ORIGINAL Application 94-04-002 (Filed April 1,1994)

(See Appendix A for appearances.)

OPINION

I. Introduction

By this decision, we decide the reasonableness of the 1993 record period Electric Department operations of Pacific Gas and Electric Company (PG&E). Some Gas Department issues were addressed in our decision approving a joint stipulation between PG&E and the Office of Ratepayer Advocates (ORA)[1] (Decision (D.) 96-12-089.) Other gas issues remain pending in the consolidated gas accord proceeding, Application (A.) 92-12-043 et al. Except for the matters noted below, we find that PG&E's electric operations during the 1993 record period were reasonable.

II. Procedural Background

PG&E filed its application under the Energy Cost Adjustment Clause (ECAC) in this docket on April 1, 1994. ORA filed its report on all aspects of PG&E's electric reasonableness showing, except for economy energy sales, on September 2, 1994. ORA submitted its chapter on the reasonableness of PG&E's economy energy sales on November 15, 1994.

On February 6 and March 27, 1995, PG&E filed a motion and amended motion to strike the portion of ORA's report recommending a $240,000 disallowance for economy energy sales allegedly made at a loss to avoid hydro spill conditions, as outside the scope of the reasonableness proceeding under the Diablo Canyon Settlement Agreement. Finding that ORA had a reasonable basis for its interpretation of the Diablo agreement, a ruling of the assigned Administrative Law Judge (ALJ) denied this motion on January 19, 1996.

In May 1996, PG&E submitted additional information regarding the numbers that would be used by ORA for its recommended disallowance for economy energy

[1] ORA participated in these proceedings under the name of its predecessor organization, the Commission's Division of Ratepayer Advocates.

sales made at a loss to avoid hydro spill conditions, in response to an earlier data request by ORA. Hearings scheduled for May were postponed while ORA reviewed this material.

Hearings were held on July 2 and 3, 1996. ORA and PG&E were the only parties to sponsor testimony. Opening, Reply and Sur-reply briefs were filed by PG&E and ORA between July 30 and September 17, 1996.

III. Reasonableness Issues

Except for three areas, ORA considers the operations of PG&E to have been reasonable in 1993. ORA recommends that the Commission disallow $352,000 for off-system sales made to avoid hydro spill conditions, $334,000 for not utilizing the Helms pumped storage facility, and $80,000 for uneconomic off-system economy energy sales. ORA states that these disallowances are not cumulative for the hours in which they overlap. PG&E disputes the merits of the proposed disallowances, and argues for an alternative amount of $110,000 for the Helms issue, should this disallowance be recognized by the Commission.

A. Hydro Spill Conditions

1. Background

1993 was the first wet hydro year since the adoption of the Settlement Agreement in 1988. During 1993, PG&E was faced at times, typically on spring nights, with decreasing load on its system and the need to either (1) back-down generation facilities or (2) increase load in order to avoid allowing water to spill, that is, to bypass its hydro generation facilities. On some occasions, PG&E made economy energy sales, (i.e., sold energy off-system at a discount) rather than back-down Diablo Canyon. Although the ratepayers receive the benefit of any price PG&E accepts for the sale of the electricity, they are still bound, in PG&E's opinion, to pay the full settlement rate for the production of Diablo Canyon. PG&E claims that these sales are explicitly allowed by the Settlement Agreement and that it should be able to recover the full settlement rate, no matter how cheaply the energy was sold. ORA contends that when PG&E sells energy off-system rather than spilling hydro, it may not recover the full settlement rate from ratepayers, but instead may only retain the rate paid by the economy energy purchaser.

Resolution of this issue requires interpretation of the Diablo Canyon Settlement Agreement (hereinafter "the Settlement Agreement") as approved by the Commission in D.88-12-083. (Re Pacific Gas & Electric, 30 CPUC2d 189.) The Settlement Agreement provides in Paragraph 11 that:

> "PG&E shall have the right and obligation to purchase all Diablo Canyon output, except during hydro spill conditions on the PG&E system. During hydro spill conditions, ratepayers shall not pay for Diablo Canyon output to the extent of the hydro spill. PG&E shall, however, have the right during such conditions to sell Diablo Canyon output."

The decision approving the Settlement Agreement comments on Paragraph 11 as follows:

> "See the Implementing Agreement for the definition of hydro spill. The effect of this paragraph is that the ratepayers are obligated to pay for Diablo Canyon power as if it were purchased by PG&E under a power purchase contract at the escalating prices set forth in this agreement." (30 CPUC2d 189, 263.)

Under this portion of the Settlement Agreement (hereinafter "Paragraph 11"), PG&E is allowed to charge a pre-established rate for all of the output of Diablo Canyon, except when hydro spill conditions exist. In 1993 the established rate for Diablo energy was 11.154 cents/kWh.[2] (30 CPUC2d 189, 255.) Because the established rates for Diablo energy are relatively high, PG&E has an obvious economic

---

[2] The Settlement Agreement sets a fixed price component of 31.5 mills/kWh over the term of the agreement plus an escalating price component equal to 80.14 mills/kWh in 1993. (30 CPUC2d 189, 255.)

incentive to avoid hydro spill conditions. In order to avoid hydro spill, PG&E instructs its dispatchers to "make all sales possible down to a floor price of zero" (Step 17) prior to backing down Diablo (Step 19) or curtailing hydro (Step 22). (PG&E Generation Backdown Order, Exhibit (Exh.) 204, Attachment A.) The question presented for decision is whether PG&E may reasonably sell economy energy, at prices down to zero, in order to avoid hydro spill conditions, while continuing to collect over 11 cents per kWh for Diablo output from the ratepayers in 1993. For the reasons set forth below, we hold that they may not.

The sections which follow summarize the positions of the parties. The arguments presented are not always internally consistent, particularly parties' alternating reliance on and rejection of the precedential value of D.82-04-071, 8 CPUC2d 653, our decision establishing rules regarding electric utility purchases from cogeneration and small power production facilities (QFs).

2. Position of PG&E

PG&E's primary argument is that the plain language of the Settlement Agreement permits the sale of economy energy in order to avoid hydro spill. PG&E claims that the "plain words of the Settlement Agreement govern the rights and obligations of PG&E." (PG&E Opening Brief at 4.) To interpret the term "hydro spill conditions" in the Settlement Agreement, PG&E cites the Commission's QF-related decision, D.82-04-071, 8 CPUC2d 653. PG&E states that hydro spill "has already been defined by the Commission in D.82-04-071" and occurs only when all of the following conditions are met:

> a. all utility-owned non-hydro plants are shut down or are operated at the minimum level practical,
>
> b. all non-QF electricity purchases are curtailed the maximum amount possible without breaching contract terms,
>
> c. the utility is making all feasible economy sales, and

d. if it accepts full QF power, the utility must spill its own hydro resources.

(Id. at 5, quoting D.82-04-071 (1982), 8 CPUC2d 653, 657.) PG&E claims that based on the definition in D.82-04-071, "a hydro spill condition exists only <u>after</u> all feasible economy energy sales have been made." (Id. at 6, emphasis added.)

PG&E asserts that since Paragraph 11 disallows sale of Diablo output only "to the extent of" the hydro spill, it must mean actual hydro spill. (Id.) PG&E recognizes only one instance in which the ratepayers are not obliged to pay the settlement price for Diablo energy, i.e., if an opportunity to make a sale arose after hydro spill began, "then and only then does PG&E receive the sale price for Diablo generation." (Id. at 7.)

Regardless of how hydro spill is defined, PG&E contends that under Paragraph 8.D of the Settlement Agreement "there shall be no issue in any proceeding as to the reasonableness of PG&E in operating Diablo Canyon . . . so as to cause replacement or displacement power costs to be incurred." (Id. at 8.) PG&E considers the buying and selling of off-system energy a replacement or displacement resource which does not give rise to a Diablo reasonableness review. (Id. at 9.)

3. Position of ORA

Like PG&E, ORA argues that the plain language of the Settlement Agreement supports its position. In addition, ORA contends that the intent of the parties and public policy considerations stand opposed to PG&E's sale of economy energy to avoid hydro spill.

ORA, like PG&E, cites D.82-04-071. ORA argues that D.82-04-071, issued and therefore part of California law at the time of the settlement, requires PG&E to sell surplus power in order to avoid actual hydro spill. (ORA Response of 2/21/96 at 5.) ORA asserts that "hydro spill conditions" must therefore not mean <u>actual</u> hydro spill, since PG&E is already directed to avoid this through sales of economy energy, but must instead mean "conditions under which, in the absence of D.82-04-071, the utility would have to decide whether to sell or spill." (Id.)

ORA contends that the language of Paragraph 11 precludes PG&E from selling power at a loss to ratepayers. (ORA Opening Brief at 10.) In Exh. 209, ORA notes that although the Settlement "specifically allows sale of Diablo generation rather than backing it down or spilling hydro," it does not "specify the unit cost of the sale." (Exh. 209 at 7-2.) ORA states that "clearly, ORA did not intend for PG&E to sell the power at a loss to the ratepayers." (Id.)

ORA points out that the Settlement Agreement decision's discussion of Paragraph 11 refers to the Implementing Agreement for the definition of hydro spill. The implementing agreement defines hydro spill as "water which bypasses a hydroelectric unit which is capable of additional generation but for which no load is available and capable of being served." (ORA Reply Brief at 5.) Noting that the definition is quite short relative to other discussion sections in the decision, ORA turns to the testimony of the parties. (Id.) ORA cites the testimony of its own regulatory analyst, quoted in the Settlement decision, for his interpretation that the hydro spill provision ensures that ratepayers will "not be forced to take power from Diablo Canyon when lower cost hydroelectric power is available." (Id. at 6.)

After originally citing D.82-04-071 for the requirement that PG&E make economy energy sales to avoid hydro spill, ORA later asserts that PG&E erroneously relies on D.82-04-071. (Id. at 3.) ORA cites PG&E's own answer prior to adoption of the Settlement agreement regarding the definition of hydro spill; specifically its answer to Question 3.C. in Attachment 1 to Exh. 202, <u>Answers of Pacific Gas & Electric Company to Data Request of the Commission Advisory and Compliance Division,</u> (Exh. 524 in the Settlement Agreement decision, D.88-12-083.) There, in response to the Commission's Advisory and Compliance Division (CACD) query as to whether the definition of hydro spill in the Settlement Agreement is the same as in D.82-04-071, PG&E replied, in part:

> No. Hydro spill is defined for purposes of the QF contracts by the Commission's Decision 82-04-071 . . . For purposes of the Diablo Canyon settlement however, "hydro spill" is defined as occurring in the PG&E system whenever water "bypasses a hydroelectric unit which is capable of additional generation but for which no load is available and capable of being served."

(Id. at 9.) ORA argues that having explicitly disavowed D.82-04-071's definition of hydro spill on the record in the Settlement Agreement Decision, PG&E may not now claim that this definition controls.

4. Discussion

The California Civil Code and centuries of common law have given us the principles used in the interpretation of agreements. A contract must be so interpreted as to give effect to the mutual intention of the parties. (Civ. Code § 1636.) Words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning. (Civ. Code § 1644.) The whole of a contract is to be taken together so as to give effect to every part. (Civ. Code § 1641.) A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties. (Civ. Code § 1643.)

Were we to decide this issue based on the intentions of the parties to the Settlement Agreement, we would find it difficult from the record to agree with PG&E's interpretation. PG&E's interpretation relies upon the plain language of the statute, rather than the parties' intent, to support its position. PG&E is not so bold as to claim outright that the parties intended that PG&E would be allowed to dump energy through economy sales, rather than back-down Diablo, at the expense of the ratepayers.

In this case, however, we are not constrained by the parties' intent. As we noted in our decision approving the Settlement agreement, "a settlement, when adopted by [the Commission], is not a contract between parties but a decision of the Commission." (D.88-12-083 (1988) 30 CPUC2d 189, 227.) To the extent that the

Commission's interpretation differs from that of the parties, or any of them, it is the Commission's interpretation that is definitive. (Id. at 226.) To the extent the settlement requires interpretation after it is adopted in a Commission decision, it is the Commission's interpretation that prevails. (Id. at 227.) The proper inquiry before the Commission is not to determine the intent of the parties to the Settlement Agreement, but rather to determine the intent of the Commission in approving it.

In general, the decision adopting the Settlement Agreement took care to articulate the Commission's interpretation of its terms. The discussion of Paragraph 11, however, refers solely to the Implementing Agreement for the definition of hydro spill. The Implementing Agreement reads:

> "'Hydro-spill' is defined as water which bypasses a hydroelectric unit which is capable of additional generation but for which no load is available and capable of being served. Hydro spill does not include water which may bypass a fully loaded unit due to reservoir storage limitations."

Normally, we would be reluctant to look outside the four corners of the writing for the interpretation of an agreement; however, the definition provided here is not dispositive of the question before us. It is merely a description of the physical properties of hydro spill. ORA, noting this definition's brevity in relation to other concepts defined in the Settlement (such as "floor" or "segregation of costs"), suggests that we should look further into the parties' positions and responses to questions for a more useful definition. We agree.

Both ORA and PG&E note that "hydro spill" had been defined in a prior decision of the Commission, decided before adoption of the Settlement Agreement. As set forth above, in D.82-04-071, the Commission defined hydro spill as occurring when "all utility owned nonhydro plants are shut down or are operated at the minimum level practical, and all non-QF electricity purchases are curtailed the maximum amount possible without breaking contract terms, and the utility is making all feasible economy sales, and if it accepts full QF power, the utility must spill its own hydro resources." (8 CPUC2d 653,657.)

ORA and PG&E each attempts to turn the definition of hydro spill conditions in D.82-04-071 to its own advantage: ORA uses it as proof that hydro spill conditions may exist without actual hydro spill; PG&E uses it as proof that economy sales are not only allowed to avoid hydro spill but in fact are required before hydro spill is recognized. However, both ORA and PG&E have also argued that this definition is not applicable, having been specifically rejected by PG&E in its response to CACD's Data Request in the Settlement proceedings. PG&E argues this point in its Motion to Dismiss of February 21, 1996. ORA argues the same point in its Reply Brief.[3]

As set forth above, in its answer to CACD, PG&E stated that, "For purposes of the Diablo Canyon settlement, ..., 'hydro spill' is defined as occurring in the PG&E system whenever water 'bypasses a hydroelectric unit which is capable of additional generation but for which no load is available and capable of being served.' (See Position of PG&E, *supra*.) It appears that at the time the Diablo Settlement was negotiated, at least in the mind of PG&E, the definition of hydro spill from D.82-04-071 was not to be imported into the Settlement Agreement. Because it was specifically rejected by PG&E, we hold that the definition from D.82-04-071 does not control here. However, neither can we accept the brief definition stated by PG&E in its response. There is no indication in the record that this short definition was accepted by ORA or the Attorney General. Moreover, the definition is essentially the same description that appears in the Implementing Agreement, and consequently, moves us no closer to a useful definition of hydro spill.

Without explicit guidance from the Settlement Agreement, its exhibits or from a definition in our prior decisions, we must interpret hydro spill in a

---

[3] Even without both parties' repudiation of the definition of hydro spill in D.82-04-071, we would be reluctant to import it into the Settlement Agreement. That decision modified D.82-01-103, 8 CPUC2d 20, which recognized California's long-standing demonstrated interest in promoting cogeneration and small power production as alternative sources of energy generation. The definition of hydro spill in D.82-04-071 is driven by its goal that utilities avoid, if possible, the curtailing of Qualifying Facilities (QFs). There is no corresponding demonstrated interest in promoting the nuclear power generation industry.

way which gives a reasonable effect to Paragraph 11. We agree with PG&E that D.88-12-083 "recognized that the performance-based nature of Diablo Canyon ratemaking depended upon PG&E recovering based on the plant's output at all times except during those rare times when the benefits of performance based ratemaking were outweighed by the public policy interest in not wasting the valuable, unique hydroelectric resources of the state." (PG&E Exh. 202 at 7.) We disagree, however, with PG&E's contention that this statement of policy implies that actual hydro spill is required to relieve the ratepayers from their obligation to purchase Diablo output.

We cannot understand how the valuable, unique hydroelectric resources of California are not wasted when PG&E chooses to sell energy off-system, down to a price of zero, rather than backing down Diablo. Such a sale by PG&E transfers the benefits of lower cost hydroelectric energy from the ratepayers of California to PG&E and to the purchasers of its economy energy. PG&E does not dispute this outcome, but merely maintains that it is allowed by the Settlement Agreement. We find this result, and therefore PG&E's interpretation of Paragraph 11, to be inequitable and unreasonable.

ORA suggests that the term "hydro spill conditions" in Paragraph 11 be defined as "conditions under which, in the absence of D.82-04-071, the utility would have had to decide whether to sell or spill." (ORA Response of February 21, 1995 to PG&E's Motion to Dismiss at 5.) This interpretation gives effect to every part of the Settlement Agreement and avoids an unreasonable result by preserving the benefits of lower cost hydroelectric power for the ratepayers of California. This interpretation also treats PG&E fairly. Under the Settlement Agreement, PG&E is able to make economy energy sales during "hydro spill conditions." PG&E's earnings on such sales must be calculated, however, by the transaction price, not the rates specified in the Settlement Agreement.

Consequently, for the purposes of the Settlement Agreement, we define the phrase "hydro spill conditions" as conditions under which, in the absence of D.82-04-071, PG&E is faced with the choice of either selling economy energy or spilling hydro. Actual hydro spill is not required. Under such circumstances, the ratepayers are excused from their obligation to purchase Diablo output to the extent of the sale or hydro spill. Using this definition, we disallow $352,000 of PG&E's expenses as unreasonable for 1993.

B. Helms Pumped Storage Facility

1. Background

The Helms pumped storage project is a hydroelectric facility located on the Kings River, approximately 50 miles east of Fresno, between Courtright Lake and Lake Wishon. Helms uses three reversible pump turbine units, each capable of generating over 375 MW of electricity. At off-peak times, the generating units can be reversed to pump water from Lake Wishon back into Courtright Lake. This stored energy can then be used when needed by allowing the water to fall back into Lake Wishon.

ORA contends that PG&E has failed to show that it operated Helms in a reasonable fashion in 1993 and requests a disallowance of $334,000.

a) Position of ORA

Although ORA originally considered PG&E's operation of Helms to be reasonable (Electric Reasonableness Report, Exh. 208), ORA now contends that PG&E has failed to carry its burden regarding the reasonableness of its economy sales of energy. (ORA Opening Brief at 2.) ORA asserts that PG&E's inability to provide any substantive evidence regarding its method of assessing the decisions of its dispatchers to sell economy energy, other than an after-the-fact analysis of actual savings or loss, constitutes a failure to show the reasonableness of its actions. ORA proposes that PG&E establish parameters on the level of loss or risk acceptable for economy energy transactions and that these parameters be used in the future to determine the reasonableness of PG&E's sales of economy energy. (Id. at 6.)

ORA contends that PG&E has no written record that Helms units were not available for pumping and that speculation by PG&E regarding possible constraints on Helms should be given little if any weight. (Id. at 8.) ORA asserts that PG&E's focus on the results of its operations, rather than whether its actions were reasonable in light of facts at the time decisions were made, does not satisfy PG&E's burden of proof. (ORA Reply Brief at 11.)

b) Position of PG&E

PG&E claims that its operation of Helms was reasonable in 1993. PG&E argues that keeping more detailed notes of its dispatchers' decisions to pump Helms would be "extremely repetitious and tedious" and moreover, would not end the inquiry as to whether the forecasted incremental cost of power at the expected time of generation was reasonable. (PG&E Opening Brief at 11.) PG&E contends that the decision "can only be reasonable if the result is net ratepayer benefits most of the time." (Id.)

PG&E states that selling energy and pumping Helms are equivalent resource choices that should be based on economics. (Id. At 16.) PG&E asserts that, "except for a few days in the middle of June,. . . ratepayers were better off selling the energy than pumping Helms." (Id. at 17.) PG&E estimates the net benefit to ratepayers at almost $6 million and disputes ORA's calculation of a $334,000 disallowance. PG&E contends that when calculated on an hourly basis, hours showing losses total only approximately $110,000. (Id. at 19.) Finally, PG&E resists ORA's suggestion that parameters be set for dispatchers as completely arbitrary in application. (PG&E Reply Brief at 4.)

c) Discussion

In this proceeding, the burden is placed on the utility to make a showing that its operations were reasonable. PG&E correctly cites the legal standard for reasonableness, *viz.*, whether the utility's actions reflect the exercise of reasonable judgment in light of facts known or which should have been known at the time the decision was made. (D.96-05-062, slip op. at 34 quoting Re Southern California Edison, D.87-06-021(1987) 24 CPUC2d 476, 486.) Having recognized the standard, PG&E then ignores it and asserts that the reasonableness of its Helms operations can only be determined *ex post* by the results of those operations.

The problem in making the determination of reasonableness in this case is exacerbated by PG&E's failure to keep contemporaneous records of the factors considered by its dispatchers as decisions are made to sell economy energy rather than pump Helms. It is easy with the benefit of hindsight to see that the preponderance of these transactions probably resulted in benefits to ratepayers. But this conclusion begs the real question of whether the decision was reasonable at the time the decision was made. PG&E's reliance on the net effects of its decisions as proof of their reasonableness is misplaced.

The decisions made by dispatchers throughout the day are no doubt complex and informed by many quantitative and qualitative factors. PG&E cannot be expected to reduce every factor considered to writing. But it is not too much to require that key data such as the anticipated incremental cost of the energy sold, the number of Helms units available to pump, and the corresponding anticipated cost of pumping Helms be recorded for future reference. PG&E complains that since thousands of these transactions occur each year, this procedure would be tedious and repetitious. We are not convinced that making such a notation, even if it were done several times per shift, would be as burdensome as PG&E claims. We agree with PG&E that such notations would not end the inquiry into whether the economy sales were reasonable. What they would do, however, is provide a starting point for such a determination. Without the production of data regarding the facts available at the time these decisions were made, we cannot say that PG&E has carried its burden of proof on this issue.

ORA's calculation of the proposed $334,000 disallowance is based on its analysis of sales of economy energy in the month of June 1993 only. (Exh. 210.) PG&E's analysis supporting its maximum disallowance of $110,000 covers the entire 1993 record period. (Attachment to PG&E Opening Brief.) We find PG&E's

analysis to be the more comprehensive and adopt a disallowance of $110,000 for this issue.

C. Economy Energy Sales

Economy energy is nonfirm electric energy purchased by one utility from another and substituted for energy that would have been more expensively generated by the utility's own system. (PG&E, Resource: An Encyclopedia of Utility Industry Terms [1985]). "PG&E makes economy energy sales when it forecasts that the sales price will exceed the incremental cost of producing the energy." (PG&E Opening Brief at 12.) ORA contends that $80,000 should be disallowed for economy energy sales made by PG&E in 1993 where the cost of producing the energy exceeded the price received from the buyer.

1. Position of PG&E

PG&E claims that "the only certainty about forecasts is that they will be wrong some of the time." (PG&E Opening Brief at 12.) When the price received exceeds the cost of producing the energy, ratepayers benefit from the sale. If the forecasted cost of the energy exceeds the price received, there is a loss. PG&E contends that the utility's forecasting is reasonable if "the benefits to the ratepayer of making the sales far outweigh any costs." (Id.) PG&E claims that in 1993, it made over $15.5 million in economy energy sales and that these sales resulted in over $1.5 million in gross profit. PG&E argues that "the fact that [ORA] was only able to identify $80,000 of negative contributions" from these transactions "only demonstrates that PG&E's forecasting of incremental costs was both conservative and reasonable." (Id. at 13.)

PG&E argues that it would be fundamentally unfair to penalize PG&E for these "negative contributions" while allowing ratepayers to keep all the benefits when the sales are economic. (Id.) Moreover, PG&E claims that if the utility is allowed only to make economy energy sales guaranteed to benefit ratepayers, then its dispatchers will become more conservative and fewer economy energy sales will be made.

PG&E acknowledges that there is no written record of forecast assumptions used when selling economy energy. PG&E claims not to have kept such records because, "in addition to being tedious and very time-consuming, it would not determine whether PG&E was acting reasonably." (PG&E Reply Brief at 2.)

2. Position of ORA

ORA contends that PG&E has not met its burden of demonstrating that its economy energy sales in 1993 were reasonable. ORA argues that PG&E failed to explain how it evaluates the reasonableness of such sales. (ORA Opening Brief at 2.) ORA points to several unsuccessful attempts made by the presiding ALJ during these proceedings to elicit a response from PG&E regarding their methods for assessing economy energy sales decisions. (Id. at 2-4.) ORA argues that "PG&E's after the fact analysis says very little about the decisionmaking process at the time the decisions were made." (Id. at 3.) ORA notes that "it may be that PG&E undertook unreasonable risks" in its sales of economy energy, "or that savings would have been substantially higher had more prudent decisions been made." (Id.)

ORA suggests that parameters be set for future determinations of the reasonableness of PG&E's operations, for example, requiring dispatchers to avoid sales that could result in losses of 1/8 or 1/4 of one percent of the entire transaction price. (Id. at 6.)

3. Discussion

We find that ORA's suggestion that each and every transaction be profitable to be found reasonable to set unreasonable expectations for performance in a competitive market. We find that overall, PG&E management of its economy sales programs was reasonable.

We decline to adopt ORA's suggestion that a numeric standard be adopted for future determination of reasonableness. Such a standard would be purely arbitrary at this time. In the ALJ's proposed decision the ALJ found that PG&E "had failed in the area of economy energy sales to maintain adequate records of its sales decisions," and that PG&E had not carried its burden of proof. We reject that analysis and find that maintaining and providing documentation of the factors considered at the time the dispatcher agrees to the sale of economy energy is an over-bearing standard for such operational calls. The ALJ agrees that the sales may, indeed, have been reasonable. Overall, we find PG&E management of economy sales to be reasonable.

We note, however, that no regulator can ever be assured that a cost-of-service regulated entity is selling its output "off system" at negotiated prices is doing so at the best prices possible. The very nature of cost-of-service regulation blunts the incentives for a utility so regulated to maximize the profitability of off-system sales. After the fact reasonableness is a very poor second best solution when compared to a properly constructed incentive based regulatory framework.

4. Conclusion

Based on the discussion above, we find PG&E acted unreasonably in two areas: (1) its off-system sales made to avoid hydro spill conditions and (2) its utilization of the Helms pumped storage facility. Therefore, we disallow $462,000 in electric costs for PG&E's 1993 record period. PG&E should credit this amount, plus applicable interest charges accrued since December 31, 1993, to its electric deferral refund account established by D.96-12-025, within ten days of the effective date of this decision.

Findings of Fact

1. PG&E filed its application on April 1, 1994 requesting a Commission finding that Electric Department Operations during the 1993 record period were reasonable.

2. ORA reviewed PG&E's Electric Department operations during the 1993 record period and found them reasonable except for various items noted in its report (Exhs. 208-210).

3. ORA recommends that a disallowance be imposed on PG&E in the amount of $352,000 related to off-system sales of economy energy made in order to avoid hydro spill conditions during the 1993 record period.

4. PG&E, while disputing the merits of ORA's recommended $352,000 disallowance, does not dispute the amount as calculated.

5. ORA recommends that a disallowance be imposed on PG&E in the amount of $334,000 for not utilizing the Helms pumped storage facility in a reasonable manner during the 1993 record period.

6. PG&E disputes the merits of a disallowance for failure to pump Helms and, using different assumptions, calculates the potential disallowance of the Helms issue as $110,000.

7. ORA recommends that a disallowance be imposed on PG&E in the amount of $80,000 for making unreasonable sales of economy energy during the 1993 record period.

8. PG&E disputes the merits of the proposed disallowance for economy energy sales but does not dispute the amount as calculated.

9. ORA states that its recommended disallowances may overlap and are not cumulative for the hours they cover.

10. PG&E has failed to provide documentation regarding the particular information used and assumptions made by its dispatchers in making sales of economy energy.

11. PG&E has failed to provide documentation regarding the particular information used and assumptions made by its dispatchers in deciding whether or not to pump Helms.

12. It was not the intention of the parties to the Diablo Canyon Settlement Agreement that PG&E should be allowed to charge the full Settlement Agreement rate to ratepayers while making off-system sales of economy energy to avoid hydro spill conditions and to avoid backing down Diablo generation.

13. In a reasonableness review, the burden is placed on the utility to prove that its operations were reasonable.

14. The legal standard of reasonability is "whether the utility's actions reflect the exercise of reasonable judgment in light of facts known or which should have been known at the time the decision was made."

15. ORA has not provided a comprehensive estimate of the amount of disallowance appropriate for the Helms issue in the 1993 record period.

Conclusions of Law

1. PG&E's Electric Department operations during the 1993 record period were reasonable, except for and subject to the items noted below.

2. A settlement, when adopted by the Commission, is a decision of the Commission. To the extent that the settlement requires interpretation after its adoption, it is the Commission's interpretation that is definitive.

3. PG&E's interpretation of the Diablo Canyon Settlement Agreement, *viz.*, that PG&E should be allowed to charge the full Settlement Agreement rate to ratepayers while making off-system sales of economy energy to avoid hydro spill conditions and to avoid backing down Diablo generation, is unreasonable.

4. For purposes of the Settlement Agreement, hydro spill conditions are defined as those conditions under which, in the absence of D.82-04-071, PG&E is faced with the choice of either selling economy energy or spilling hydro. Actual hydro spill is not required.

5. Under "hydro spill conditions" as defined, the ratepayers are excused from their obligation to purchase Diablo output to the extent of the sale or hydro spill.

6. Of PG&E's expenses in 1993 related to economy energy sales under hydro spill conditions as defined, $352,000 are unreasonable and should be disallowed.

7. PG&E has failed to carry its burden of proving that its decisions to sell economy energy rather than pumping Helms were reasonable.

8. Of PG&E's expenses in 1993 related to the decision to pump Helms, $110,000 are unreasonable and should be disallowed.

9. PG&E's economy energy sales in the 1993 record period are reasonable.

ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) shall not recover in rates $352,000 in Electric Department costs associated with its Diablo generation during hydro spill conditions during the 1993 record period.

2. PG&E shall not recover in rates $110,000 in Electric Department costs associated with its decision to sell economy energy rather than utilizing the Helms pumped storage facility during the 1993 record period.

3. PG&E shall credit $462,000, plus applicable interest charges accrued since December 31, 1993, to the electric deferral refund account established in Decision 96-12-025 within 10 days of the effective date of this order.

This order is effective today.

Dated August 1, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners

****
APPEARANCES*
****

M.Alcantar/D.Williams, Jr.
ATER WYNNE HEWITT DODSON
AND SKERRITT
222 SW Columbia, Ste 1800
Portland, Oregon 97201

Andrew Brown, Rsrc Analyst
BARAKAT & CHAMBERLIN INC.
1800 Harrison St., 18th Flr.
Oakland, CA 94612

Reed Schmidt, Sr. Consultant
BARTLE WELLS ASSOCIATES
1636 Bush Street
San Francisco, CA 94109

Gordon E. Davis, Atty at Law
BROBECK PHLEGER AND HARRISON
#3100 Spear Street Tower
One Market Plaza
San Francisco, CA 94105

Steve Gehringer, Atty at Law
CALIF FARM BUREAU FEDERATION
405 "I" Street, Suite C
Madera, CA 93637

Cheryl Jacobsen
CA/NEV COMMUNITY ACTION ASSN
926 'J' Street, Suite 408
Sacramento, CA 95814

S. Greenwald/Mark Trinchero
DAVIS WRIGHT TREMAINE
235 Pine Street, Suite 1500
San Francisco, CA 94104

James Squeri
GOODIN, MAC BRIDE, SQUERI,
SCHLOTZ & RITCHIE, LLP
505 Sansome Street, Suite 900
San Francisco, CA 94111

Dian Grueneich, Atty at Law
GRUENEICH RESOURCE ADVOCATES
582 Market St. Suite 407
San Francisco, CA 94104

Eric Karlson
EDSON & MODISETTE
925 L Street, Suite 1490
Sacramento, CA 95814

Douglas Kerner, Atty at Law
ELLISON SCHNEIDER & LENNIHAN
5180 Cameron Road
Cameron Park, CA 95682

Judy Pau, Reg. Analyst
Phil Endom, Atty at Law
EL PASO NATURAL GAS COMPANY
650 California St., 24th Floor
San Francisco, CA 94108

Philip Stohr/R.Liebert, Esqrs
DOWNEY BRAND SEYMOUR & ROHWER
555 Capitol Mall, 10th Floor
Sacramento, CA 95630

David R. Branchcomb
HENWOOD ENERGY SERVICES
2710 Gateway Oaks Drive, Suite 300-N
Sacramento, CA 95833

Jan Smutney-Jones, Exec Dir.
INDEPENDENT ENERGY PRODUCERS
1112 'I' Street, Suite 380
Sacramento, CA 95814-2823

William Booth, Atty. at Law
JACKSON TUFTS COLE AND BLACK
650 California St., 32nd Flr.
San Francisco, CA 94108

Lynn Haug/J. Bloom, Esqrs
MORRISON AND FOERSTER
345 California Street
San Francisco, CA 94104

Norman Furuta, Atty at Law
DEPARTMENT OF THE NAVY
DEPARTMENT OF DEFENSE
900 Commodore Dr. (CODE 09C)
San Bruno, CA 94066-2402

E. KURZ/D. WALKER
Attorneys at Law
PACIFIC GAS AND ELECTRIC COMPANY
77 Beale Street, Room 3081
San Francisco, CA 94106

D.E. Clark/L.G. Van Wagenen
Attorneys At Law
SAN DIEGO GAS AND ELECTRIC
101 Ash St.
San Diego, CA 92101

Mark Younger
SLATER CONSULTING
35 Werking Rd. E.Greatbush
East Greatbush, NY 12061

Rob Finkelstein/Theresa Mueller
THE UTILITY REFORM NETWORK
711 Van Ness Avenue, Suite 350
San Francisco, CA 94102

Steve Harris
TRANSWESTERN PIPELINE CO.
1400 Smith Street, EB 4160
Houston, TX 77002

Joseph Deulloa
Room 5216
CPUC

Carol Dumond, LEGAL DIV
RM. 5127
CPUC

****
STATE SERVICE*
****

ALJ CHRISTINE WALWYN
Rm. 5101
CPUC

Hallie Yacknin, LEGAL DIV
RM. 5022
CPUC

Natalie Walsh
Room 4205
CPUC

Raymond Charvez
RM. 4011
CPUC

Robert Feraru, Public Advisor
RM. 5304
CPUC

Godson Ezekwo
RM. 4205
CPUC

Sandra Fukutome
RM. 4205
CPUC

Michael Epperson
BAY AREA RAPID TRANSIT DISTRICT
800 Madison Street

P.O. Box 12688
Oakland, CA 94604-2688

Barbara Ortega
CALIFORNIA PUBLIC UTILITIES COMMISSION
107 S. Broadway, Room 5109
Los Angeles, CA 90012

****
INFORMATION ONLY
A. 94-04-002
****

Barbara Barkovich, Principal
BARKOVICH & YAP, INC.
P.O. Box 11031
Oakland, CA 94611

David Hicks
MORSE RICHARD WEISENMILLER
AND ASSOCIATES
1999 Harrison St., Ste 1440
Oakland, CA 94612

Sid Carter
RECON RESEARCH CORPORATION
6380 Wilshire, Ste. 1604
Los Angeles, CA 90048

James A. Ross
REGULATORY/COGENERATION SVCS
500 Chesterfield Ctr, Ste 320
Chesterfield, MO 63017

Janet K. Lohmann/David R. Hinman
SOUTHERN CALIFORNIA EDISON CO.
2244 Walnut Grove Ave., Ste 349
Rosemead, CA 91770

Albert Boyce
TANNEHILL ELECTRIC COMPANY
P O Box 871
Manteca, CA 95336

Arnold Rosenthal, V.P.
UTILITY RESOURCE MANAGEMENT
GROUP
3700 Campus Drive, Ste. 201
Newport Beach, CA 92660

(END OF APPENDIX A)