E-8 Alternate *

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION E-3021
March 25, 1987

RESOLUTION

PACIFIC GAS AND ELECTRIC COMPANY'S (PG&E) REQUEST TO IMPLEMENT AN AGREEMENT WITH LOUISIANA-PACIFIC CORPORATION ENTITLED " AGREEMENT FOR ELECTRIC SERVICE". THE AGREEMENT PROVIDES FOR PERMANENT ELECTRIC SERVICE TO LOUISIANA-PACIFIC CORPORATION FACILITY UNDER A NEGOTIATED RATE.

INTRODUCTION

By Advice Letter 1131-E filed December 17, 1986, Pacific Gas and Electric Company (PG&E) requests authorization to implement an agreement with Louisiana-Pacific Corporation (LP) entitled "Agreement For Electric Service". The agreement provides for permanent electric service to the LP facility under a negotiated rate. The facts are as follows:

SUMMARY

1. By Advice Letter 1131-E PG&E submitted an agreement with LP for a plant located in Oroville, California. The agreement entitled "Agreement for Electric Service" is dated December 11, 1986 provides for permanent electric service to the LP facility under a negotiated rate.

2. The contract is a result of negotiations between PG&E and LP to avoid what PG&E claims would be an uneconomic bypass that would result if LP were to proceed with the proposed cogeneration project. The negotiated rates were offered as an alternative after standard rate schedules failed to dissuade LP from pursuing the proposed project. LP intends to proceed with the projects should the agreement not be approved.

POSITION OF PG&E

1. The contract rate is designed to make LP financially indifferent between PG&E service and the cogeneration alternative. The contract contains the following provisions:

- The effective date of the agreement is Spetember 1, 1987. This approximates the date on which LP could have commenced operation of the proposed cogeneration facility. LP will be charged for electric service under the regularly applicable rate schedule until the effective date.

- The agreement will be for an initial of 5 years and then for subsequent periods of 5 years each until either party cancels the contract.

- LP agrees not to install nor allow a third party to install a cogeneration unit on the premises during the contract term. In addition, LP agrees not to install the proposed turbine-generator at any other facility in the PG&E service territory.

- The contract rate is designed to make LP financially indifferent between PG&E and the cogeneration project. The costs are based on studies by PG&E and LP.

- The rate is based on several factors including:

  Net plant output, total costs of plant, fuel consumed, boiler fuel savings, electric standby requirements and other cost related factors.

  The monthly charge is adjusted semi-annually based on the inflation rate, PG&E gas rates and PG&E standby charges.

- The rate consists of an equipment and maintenance component indexed to inflation and a fuel cost component indexed to gas rates. There is a monthly minimum charge to cover PG&E's fixed cost of service.

- The contract rate under current conditions would be somewhat less than the average rate of 6.4 cents/kWh under Rate Schedule A-22, but will still allow a substantial contribution to margin.

- The contract will be made subject to Commission approval and continuing jurisdiction.

All cost data which contributes to the negotiated rate is documented in data provided to the staff.

2. The contract rate with LP was developed to prevent the uneconomic bypass of PG&E's electric system. LP has indicated that the cogeneration projects will be built if the contract does not receive Commission approval. Based on current avoidable costs, service under the contract will provide a contribution to margin of approximately $1.7 million over the initial five year term. The contract rate benefits LP by offering power for the same cost as the cogeneration project while mitigating risk.

3. PG&E ratepayers benefit from not having to pickup to the share of fixed cost which the contribution to margin will pay for and which would be lost if LP leaves the PG&E system.

4. Additionally, PG&E states that an uneconomic allocation of resources which would result from the building of a system to generate power at a cost greater than PG&E's cost to generate the power will be prevented. Thus the contract benefits both LP and PG&E customers as a whole.

5. PG&E requests that the contract rate appendix and all Attachments be kept confidential. Because the threat of bypass may cause PG&E to enter into similar agreements with other potential cogenerators, it is essential that the rate component values and Attachments remain out of the public record to protect PG&E's ability to negotiate the best deal for the benefit of its ratepayers. In addition, this confidentiality will protect any customer with whom PG&E negotiates from the release of internal information.

6. The effective date of the proposed contract with LP is to be September 1, 1987 and the initial term will be for five (5) years.

POSITION OF PROTESTANTS

1. Timely protests to Advice Letter 1131-E were filed by Public Staff Division of this Commission, Cogeneration Service Bureau and Mr. Charles Smith.

2. The Public Staff Division of this Commission (PSD) provided a detailed analysis of and protest to the filing which can be summarized below:

> The Commission should take care not to establish a precedent by approving the agreement. The obvious and most important way to avoid uneconomic bypass is to keep revenue requirements as low as possible. Another way to reduce electric bypass is to adopt rate designs (including standby charges) which more closely reflect actual cost of service.
>
> The question of whether to accept a negotiated rate is a serious one. Important and difficult issues must be addressed before it can be determined that a negotiated rate is in the ratepayers' interest. Some of the issues are the following:
>
> o whether a certain level of bypass might be desirable. Self-generation can be beneficial. If the current excess capacity disappears, self-generation will become an important resource Some self-generation is also environmentally beneficial because it productively uses wastes as fuels.
>
> o the level of expected bypass is unknown. Bypass is a threat, but until it is reasonably estimated, no one can determine how great a danger it poses and whether special contract rates should be permitted to help prevent it.
>
> o there are other ways to prevent or reduce bypass besides special contract rates. The The Commission needs to consider whether it prefers those ways of fighting bypass, or prefers special contract rates, or whether it prefers to use all ways to fight bypass. Ways to fight bypass include the control and reduction of utility expenses, cost of service revenue allocation and rate design, and appropriate standby charges.
>
> o if the Commission authorizes special negotiated rates, it must provide guidance and standards for the contracts.

Additionally PSD points out:

"A great deal of effort has been expended by both PG&E and LP in the negotiation and documentation of the proposed contract, and PSD is on the whole encouraged by the relative completeness of the showing. The essence of the contract, however, is risk -- the ratepayers' risk of loss of margin contribution versus LP's risk of taking on the burden of self-production -- and risk is notoriously difficult to quantify. The Commission should reject the proposed contract because, on the basis of PG&E's showing, the Commission cannot be certain that the following conditions have been met:

(1) More contribution to margin should be made by LP under the contract than otherwise.

(2) No countervailing costs to ratepayers should result outweighting the potential benefits of the contract.

(3) No countervailing costs to ratepayers would result from the approval of a number of similar contracts.

The contract rate negotiated by PG&E and LP would apply to all the electricity consumed by LP's facility (not an amount dependent on estimates of potential cogeneration production) and would continue for an initial period of five years, after which automatic five-year renewals would take place. Either party could terminate the agreement with one year's notice before the end of a five year increment, and LP has the option of returning to an interruptible schedule at any time.

The proposed contract charge consists solely of an energy rate applied monthly to that month's energy consumption. The energy rate is not time differentiated. There are no customer or demand charges. A minimum monthly charge will be assessed. The energy rate will be escalated semi-annually according to a weighted average of natural gas price changes and the national GNP deflator (to represent fuel and fixed costs, respectively)."

Cogeneration Service Bureau (CSB) objects to the proposal based on several major premises:

a. The (proposed) rates are tied to the fixed and variable costs of a cogeneration project that could have been built by each customer. PG&E's own costs are reflected only in floor and ceiling rates.

b. CSB protests this advice letter as improper and incomplete. The proper vehicle for approval of these added ratepayer risks and potential costs is an application and hearing. The filing is incomplete because it does not define how the lost revenue from the Agreement will be recovered.

c. CSB takes note of PSD's protest that a better way to address and prevent electric bypass is to adopt rate designs which more closely reflect actual cost of service. The Commission, by Decision 86-12-091 has agreed with its staff. In that ECAC decision, PG&E's proposed Schedule E-85 was rejected. The Commission concluded that E-85 would undermine the cost based rates which the Commission adopted for commercial and industrial customers. Schedule E-85 would have yielded reduced rates to potential cogenerators similar to the agreements filed by Advice Letters 1130-E and 1131-E. Additionally, CSB concurs with PSD that the advice letter procedure is completely inappropriate to review bypass issues and those issues must be decided in general rate cases or in other proceedings such as OIR 86-10-001 regarding changing conditions in the electric utility industry.

A protest was received from Mr. Charles L. Smith of Berkeley, California, regarding the recently approved contracts between PG&E and the Peninsula Hospitals, which we believe to be also relevant to the contract with LP proposed herein.

Mr. Smith states that the whole point of cogeneration is to receive a double benefit from the same cost of the electricity: to have and use the leftover heat for heating and air conditioning, and that he does not believe that PG&E will be able to match those double benefits with just lower rates. Mr. Smith continues by saying:

"The use of cogeneration is very much like the difference between owning and renting a home: Buying electriity is like renting, afterward you have very little to show for the money spent; with generating your own you own the system, have had other benefits such as tax writeoffs, and have a reliability which PG&E has not guaranteed..."

"The public good, which should be the PUC's concern, of cogeneration is that it makes best use of the resources, saves energy and line loss, and provides competition.

In sanctioning this attempt by a regulated monopoly to subvert competition the PUC is validating the lies and propaganda that PG&E and other private utilities have been spreading over the decades about on-site power generation, formerly called Total Energy before it was reinvented. Please look this special deal over very closely. It has dire potential for our economic system and the preservation of resources."

RESPONSE BY PG&E

1. On January 13, 1987, PG&E responded to the protests to Advice Letter 1130-E by CSB, and on January 21, 1987 responded to the PSD protest. The responses are summarized as follows:

PG&E is in agreement with PSD's statement that the Commission must develop a consistent and efficient way to deal with these negotiated rates. However, PG&E disagrees with PSD's request for a lengthy generic investigation prior to approval of any contracts. The market place will not wait for the time required for such an investigation. PG&E further states that:

"PSD questions whether a certain level of bypass might be desirable. PSD states that "if the current level of capacity disappears, self-generation will become an important resource." PG&E agrees, however timing is a key issue. Negotiated rates are a means to defer the development of generation to a time when it will be beneficial to ratepayers. Current development of on-site generation will cause rate increase for remaining ratepayers. Nothing in the LP agreement precludes future development of the generation projects. By matching the contract period to the expected period of generation surplus capacity, PG&E has preserved the potential future benefit of the project without forcing ratepayers to pay unnecessarily high rates in the interim."

"PG&E does not wish to lose contribution to fixed costs which the agreement offers while waiting for an investigation to quantify expected levels of bypass. Moreover, each negotiated rate agreement is fully justified on its own merits and does not depend on a cumulative level of bypass to benefit the ratepayers."

"PG&E has previously indicated that it intends to compete with a combination of lower utility costs and cost of service rates. However, in the current situation where average costs exceed marginal costs, flexible pricing is also a necessary element to remaining competitive. In the case of the LP Oroville plant, the on-site generation cost is approximnately 1 cent/kWh lower than the applicable E-20P (primary voltage service) rate, but 2 cents/kWh greater than PG&E's marginal costs."

"Finally, PSD argues that if the Commission authorizes special negotiated rates, it must provide guidance and standards for the contracts. PG&E agrees and expects that such will be provided in the context of the enabling resolution. Unlike PSD, PG&E recognizes the urgent need for such guidance to be provided in a timely manner and to exhibit the necessary flexibility to allow PG&E to compete in today's energy marketplace. Guidance from the generic investigation PSD seeks would quite simply come too late to save the ratepayers from increased rates resulting from expected amounts of uneconomic bypass. Advice filings are the best mechanism for the Commission to provide review and guidance. First, to be effective, each negotiated agreement must be tailored to provide the particular benefits the customer would receive through bypass. Otherwise, the customer will be better off in leaving the system. Second, industrial and commercial customers operate in unregulated environments in which they must make decisions and commitments quickly. If negotiated agreements with these customers are not approved promptly, these customers will take their business elsewhere. The full documentation provided by PG&E and the resulting thorough analysis by PSD demonstrates that the Commission has ample opportunity to review negotiated agreements through advice filings. Under the current regulatory framework, only advice filings can provide the speed and flexibility required to keep such customers on the PG&E system."

"If the Commission waits for absolute certainties before authorizing flexibility in dealing with uneconomic bypass, substantial revenue will be lost to ratepayers. The documentation provided with the advice letter filing demonstrates that ratepayers will retain a substantial contribution to margin if the contract is approved. Whether that contribution is $1.7 million over 5 years, as projected by PG&E or slightly more or slightly less does not really matter. What is certain is that the contract will retain a definite contribution to fixed costs which will otherwise be picked up by other ratepayers. The existence of a floor rate insures that PG&E will obtain a contribution over marginal generating costs over the life of the contract. Moreover, the fact that the initial term of the contract is only five years reduces the risk of countervailing costs to a negligible level."

The contract filed in Advice Letter 1131-E was negotiated to avoid uneconomic bypass which would cost ratepayers $1.7 million over 5 years. LP's intention to proceed with the project has been clearly demonstrated by its actions in obtaining a turbine-generator set. With the contract, ratepayers will be better off than without: a substantial contribution to fixed costs will be retained and the option of generation developoment when needed in the future will be available. Thus PG&E urges the Commission to approve Advice Letter 1131-E".

DISCUSSION

This advice letter is similar to Advice Letter 1130-E which was conditionally approved in Resolution E-3017, dated January 28, 1987. PG&E should be commended for developing a forward-looking approach to retaining the loads and contribution to fixed costs of potential bypassers. We see substantial conceptual merit in the methodology of determining the economic alternatives available to industrial customers through on-site generation and designing pricing terms for utility service that are competitive with the self-generation alternative. While recognizing the conceptual validity of PG&E's approach, we are concerned by the questions the protestants have raised as to whether all the relevant costs of on-site generation have been considered and whether the various costs considered have been correctly quantified. Also, certain applications may be such that the overall energy balance will be best served by letting the customer generate his/her own energy. These questions deserve closer scrutiny than is possible through the advice letter process.

We agree with PSD that the advice letter process is not the appropriate forum for considering the reasonableness of the revenue allocation impacts of these contracts. Individual contract filings obscure the magnitude of the electric bypass problem and the costs to ratepayers of applying the negotiated contract approach to all potential bypassers. Case-by-case consideration of contracts makes it more difficult to treat all affected customers consistently. Finally, a multiplicity of individual contract filings inhibits full participating by interested parties that lack the staff and resources to intervene in a series of advice letter filings. Before we conditionally approve individual contracts, we need the opportunity to consider electric bypass and negotiated contracts generically. We recognize that our intention to conduct a generic investigation before approving indivudual contracts creates the possibility of delay and the subsequent loss of contribution and load from some large customers. We intend to move expeditiously to conduct our investigation, thus minimizing these risks.

In the meantime, we conditionally authorize PG&E to carry out the terms of this contract. Our approval of this advice letter is conditioned upon an accounting for the difference in margin between the revenues under the relevant E-20 rate and the revenues actually received under the contract, an exclusion of the sales transactions under the contract from the utility's ERAM account, and future disposition of the contract in a manner consistent with our generic investigation.

The negotiated contract approach to dealing with the possibility of alternative generation raises several ratemaking concerns. Our choice lies between a potential loss of margin if LP leaves the PG&E system. By this contract PG&E has taken appropriate steps to mitigate the loss of margin. While we share the company's wishes to retain as much margin contribution as possible, we cannot impose the under recovery of margin on the captive ratepayer as would occur under the current ERAM mechanism.

As stated above, we intend to review ERAM and other aspects of the electric utility regulatory framework in an expeditious manner. The contracts have an indentifiable impact on the recovery of the utility's margin. For ratemaking purposes, the contract shall be subject to any ratemaking framework that may evolve out of the risk, return and ratemaking proceeding (Three R), or any other proceeding that confronts the issue of ratemaking flexibility and the prevention of uneconomic bypass of the utility. The contribution to margin obtained through the contract would be considered part of the margin requirement allocated to a class of ratepayers with bypass options along with ratemaking flexibility.

In Resolution E-3017 dated January 28, 1987 relative to "Agreements for Electric Service" for three Peninsula hospitals we issued the following order:

> "Pacific Gas and Electric Company and any other electric utility seeking approval of contracts that were negotiated with the intent to avoid customer by-pass by cogeneration or similar projects, except for pending Advice Letter 1131-E, shall apply to the Commission by formal application pursuant to the Commission's Rules of Practice and Procedure".

The only basis on which this contract is being handled herein through the advice letter procedure is because this contract was filed by advice letter on December 17, 1986, prior to our issuance of Resolution E-3017 on January 28, 1987. Any request for authorization of similar contracts in the future must be filed by formal application.

Our approval is conditioned upon PG&E's acceptance of the following requirements:

1. The subject contract shall be subject to reasonableness review.

2. The difference between the margin that would have been collected from sales under the relevant E-20 schedule and under the contract will be recorded in a memorandum account. The balance in the account shall earn interest at the rate applied to the utility's ECAC balance.

3. The actual sales under the contract (to commence September 1, 1987) shall be excluded from sales figures used to calculate the ERAM balance. Revenues calculated at the applicable tariff rate for the level of sales forecast for these customers shall also be excluded from the ERAM forecast.

4. This contract, the balance in the memorandum account, and the sales to these customers shall be subject to the regulatory framework that will evolve out of our generic investigation into the issue of ratemaking flexibility.

5. If the revised regulatory framework is not in place by September 1, 1987, then the difference in margin recovery shall remain in the memorandum account and the sales shall continue to be excluded from the ERAM pending Commission action to determine how the loss of margin should be allocated between shareholders and ratepayers.

6. The Commission's approval of this contract shall have no precedential affect. The Commission will evaluate the negotiated contract approach to resolving the issue of alternative generation in its pending generic proceeding. There is no presumption that any other contract will be subject to the memorandum account treatment provided by this resolution.

We stress that despite our approval of this contract, we will include the load that it represents in whatever ratemaking mechanisms are generated by our industry wide review. Let us assume that we do allow the utility flexibility to recover margin among customers within a class or classes. If a customer has executed a contract before the ratemaking mechanism has been revised and it falls within such a class, then that customer's load will be included among the load that the utility may exercise its ratemaking flexibility. The negotiated contracts should not delimit the scope of our generic proceeding.

We note that this approach would be similar to our treatment of existing long-term transportation contracts in our recent decisions establishing a new regulatory framework for our regulation of natural gas utilities. Gas sales under these contracts will be assigned to the noncore market, and the margin collected will contribute to the utility's margin requirement in the noncore market. However, specific pricing provisions of the contracts will not be considered in allocating the utility's margin between the core and noncore markets; this allocation will be made according to a costing methodology that is independent of the pricing provisions of specific noncore contracts.

FINDINGS

1. The advice letter requests Commission approval of a written agreement between PG&E and LP. This matter is being handled by advice letter because it was filed prior to our issuance of E-3017 which requires all such future contracts to be filed by formal application.

2. The negotiated contract rates are lower than LP would otherwise pay under the new E-20 rate schedule, which is the schedule under which the customers now receive electric service.

3. According to PG&E's filing, LP now plans to self-generate electricity if they are forced to pay rates under the current schedule. The negotiated agrement, if approved, would keep LP on PG&E's system, but at the lower rates.

4. PG&E is the only party in the proposed contracts subject to liquidated damages in case of cancellation of the contract.

5. PG&E has provided data to the staff to support the calculations of the special contract rates.

6. Bypass (of PG&E's service) must be prevented by control and reduction of utility expenses in conjunction with appropriate rate flexibility and should be addressed at the earliest opportunity so long as other ratepayers are indifferent to the means of preventing bypass.

7. PG&E's proposed rate Schedule E-85, a negotiable rate designed to deter large customer bypass and self-generation similar to the contract rates proposed in these advice letters was rejected by the Commission in D.86-12-091 on December 22, 1986. (Application 86-04-012).

8. The contract mitigates the potential loss of margin that would occur if the customers engaged in self-generation.

9. The contract should be subject to reasonableness review.

10. The unconditional authorization of PG&E to carry out the terms of the contract is adverse to ratepayer interests.

11. Sales made pursuant to the terms of the contract should be exlcuded from consideration in any ERAM proceeding.

12. The difference in margin contributed from sales under the relevant E-20 schedule and sales made pursuant to the contract terms (commencing September 1, 1987) should be accounted for in a memorandum account and accrue interest at the ECAC rate.

13. The contract should be subject to the new rules and ratemaking framework that emerge from our generic investigation into the appropriate level of ratemaking flexibility or other related proceeding.

14. If the electric utility ratemaking framework has not been revised by September 1, 1987, then the balance will remain in the memorandum account pending Commission action.

15. The issue of what is the appropriate utility response to the threat of alternative generation by a customer requires greater review than what we have been able to afford in this matter. We intend to address this matter in generic proceedings. Therefore, this authorization shall have no precedential effect.

THEREFORE:

1. Pacific Gas and Electric Company's Advice Letter 1131-E is approved, subject to conditions 1 through 6 listed in the text of this resolution.

2. Pacific Gas and Electric Company and other electric utility seeking approval of contracts that are negotiated with the intent to avoid customer bypass by cogeneration or similar projects, shall apply to the Commission by formal application pursuant to the Commission's Rules of Practice and Procedure.

3. The effective date of this Resolution is March 25, 1987.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on March 25, 1987. The following Commissioners approved it:

Victor Weisser

Executive Director

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
Commissioners

Commissioner John B. Ohanian,
present but not participating.