PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2876
May 10, 1989

R E S O L U T I O N

RESOLUTION G-2876. PACIFIC GAS AND ELECTRIC COMPANY AUTHORIZED TO IMPLEMENT A LONG TERM TRANSPORTATION CONTRACT WITH MOJAVE COGENERATION COMPANY. BY ADVICE LETTER 1522, FILED JANUARY 30, 1989.

SUMMARY

1. By Advice Letter 1522-G filed January 30, 1989, Pacific Gas and Electric Company (PG&E) submitted for approval a negotiated long-term gas transportation agreement with Mojave Cogeneration Company (Mojave).

2. This resolution approves the contract, with the condition that PG&E shareholders are at risk for contract revenues that are less than long run marginal costs of gas transportation services.

BACKGROUND

1. Decision 86-12-009, dated December 3, 1986, requires that all noncore gas transportation agreements having a term of 5 years or more be submitted to the Commission for approval. The Mojave contract, submitted by PG&E under Advice Letter 1522-G, provides gas transportation to the customer's proposed gas-fired cogeneration facility in Boron, California with an initial term of 15 years.

2. The project is expected to begin operation in 1990. Although the project is planned to be built in PG&E's gas service territory, it shall be located in Southern California Edison Company's (SCE) electric service territory. The electric output of the proposed plant shall be sold to SCE.

3. Mojave's gas requirements represent an incremental gas transportation load to PG&E of 30 million therms per year and are expected to generate additional gas revenues of $3 million per year. These revenues shall benefit PG&E's shareholders and customers. PG&E has negotiated this agreement with a price escalation premium to reduce the risks inherent in long-term agreements.

4. Mojave shall pay a transportation rate for the gas used to produce electricity based on the rate contained in PG&E's cogeneration Schedule G-COG or Southern California Gas Company's (SoCal) cogeneration transportation Schedule GT-50, whichever is lower. Gas used in auxiliary equipment will be billed under PG&E's industrial Schedule G-IND.

5. The priority for the transportation gas will be P3a.

PROTEST

1. The Commission Division of Ratepayer Advocates (DRA) submitted a protest to Advice Letter 1522-G on February 16, 1989 with several concerns about the contract.

2. DRA explains that the purpose and background of the contract were not fully explained in the advice letter and that, absent such information, they conclude that there are two potential motivations to this contract. The first is that PG&E negotiated this contract in response to the mandate in Public Utilities Code Section 454.4, that cogenerators receive gas at the same rate paid by electric utilities. The second motivation underlying this contract could be to retain a customer who otherwise might be lost to bypass and thus, to retain marginal revenues.

3. DRA argues that "if this contract is intended to respond to the legislative mandate in P.U.C. Section 454.4, it goes further than it needs to. A contract that provided service at the same rate paid by Mohave's customer, Southern California Edison, would presumably satisfy the mandate. Allowing the customer to swing to PG&E's rates when those are lower represents an unnecessary benefit to the cogenerator and an unnecessary loss to other ratepayers."

4. On the other hand, DRA argues that "if this contract is intended to retain a customer otherwise subject to bypass, then PG&E should have submitted documentation demonstrating that this is indeed the best rate that could be negotiated, with some showing of likely bypass cost. No such documentation was provided."

5. DRA argues that the contract with Mojave makes a long-term commitment to supply gas at potentially lower than tariffed rates, with options to terminate for the purchaser but not for the utility. DRA questions the prudence of providing such long-term service options in the absence of a broader policy on long-term sales.

6. DRA requests that the Commission reject Advice Letter 1522-G, but states that it would withdraw its objections on the condition

that "PG&E shareholders accept all risk associated with this contract, that is, to credit to ratepayers in all relevant proceedings and mechanisms an amount equivalent to the tariffed rate for this customer."

RESPONSE TO PROTEST

1. PG&E responded to DRA's protest explaining that the Mojave cogeneration project is unique. PG&E agrees with DRA that the Mojave contract represents an incremental gas load. It states that: "This is the type of load the Commission has encouraged gas utilities to seek out and bring onto their systems for the benefit of existing ratepayers."

2. PG&E states that, in addition to being an incremental load, "this project is a candidate for bypass of PG&E's gas system because it could directly link its facilities with at least one of the proposed interstate pipelines which will pass within a mile of the plant's site. Avoidance of bypass is a second element of the Commission's new transportation program."

3. In response to DRA's objections to use of the lower of the two cogeneration rates, PG&E replies that "the difference in these two rates to date has been very small. However, this provision was part of the total package negotiated. Therefore, while the difference may not be substantial, eliminating this feature would require renegotiating the entire agreement and, perhaps losing some of the provisions which benefit PG&E ratepayers, such as the 15-year term. PG&E believes that the benefits of the 15-year term far outweigh the minor concession of allowing Mojave the lesser of PG&E's or SoCal's cogeneration rate."

4. PG&E contends that "the details of negotiation on the maximum conceivable amount of ratepayer benefit are not proper subjects for (Commission) review" and that "the principal concern should be whether the negotiated rate falls between the floor of short-run marginal cost of approximately one cent per therm and the established default rate."

5. In conclusion, PG&E submits that the contract should be approved on the basis that "it aggressively captures incremental loads and avoids potential bypass while staying within authorized pricing flexibility limits."

DISCUSSION

1. Decision 85-12-102 established the beginning of the transportation program for gas customers in California. In that decision, the Commission stated that it was desirable for the utilities to offer long-term transportation contracts that "may provide some customers with greater supply certainty and rate stability" than what was available at that time.

2. Decision 85-12-102 established an "equivalent-margin recovery" method to establish the transportation rate, which sets transportation rates at the difference between retail (or wholesale) rates and the cost of purchased gas avoided by transportation. At the time, a minimum transportation rate was set at 3.5¢ per therm for retail customers.

3. The Commission warned that it would expect the utilities to procure no less advantageous terms for themselves and their sales customers than they obtain under the required tariff and, that they fully understood the need for flexible arrangements to satisfy the needs of certain customers, but did not intend for this procedure to allow the utilities and their transportation customers to institute special tariffs which would significantly disadvantage the utility's remaining sales customers.

4. The Commission's principal concern should be to provide existing ratepayers with the fundamental protection that negotiated rates for this incremental load contract must exceed long run marginal cost, which is to say that the contracts must always make some contribution to margin. The choice of long run over short run marginal cost is made because the contract term of 15 years exceeds reasonable planning and construction times for possible new pipelines. By comparison, floor price guidelines for similar electric sales contracts are based on short run marginal cost, but those guidelines apply to contracts of five years or less, which is less than the planning and construction time for major plant additions.

5. Although we do not know with certainty PG&E's current marginal transportation costs, the record in support of D.85-12-102 reasonably assures us that rates in either PG&E's Schedule G-COG or SoCal's Schedule GT-50 will exceed current long run marginal cost. For that reason we are willing to approve the Mojave contract unconditionally for the near term.

6. However, we must also protect existing ratepayers in the long term. The ratemaking policies behind current gas transportation tariffs, the possibility of the need for future pipeline construction within PG&E's system, and current market conditions all suggest that in the future PG&E's long run marginal cost may not only exceed current values but may also exceed transportation

tariff rates. If that should ever occur and if the Commission should adopt a long run marginal cost that does exceed the tariff rate, even for a short period of time, then existing ratepayers should not be made to bear the risk of this subsidy.

7. Therefore approval of the Mojave contract should be conditional. If at any time during the term of the contract the applicable contract rate is less than the adopted long run marginal cost for PG&E, then shareholders shall bear the cost of the difference. Because noncore transportation revenues are not recorded in a balancing account, the practical impact of this restriction is that in PG&E's Annual Cost Allocation Proceedings (ACAP) any estimation or allocation of transportation revenues shall assume that revenues from the Mojave contract are the higher of the rate under the contract or long run marginal cost. PG&E or any other party may in a future ACAP propose alternate methods to accomplish the same ratepayer protection, such as adjustment factors to reflect the need for capacity, etc.

8. By specifying that the long run marginal cost standard shall be based on "adopted" values we intend that shareholder risk be prospective from the time that marginal costs are adopted. We leave open the question of exactly when that determination will be made. We now anticipate that for rate design purposes PG&E's marginal costs will next be evaluated in Investigation 86-06-005. However, if the facts used to develop those costs should change, for example in review of PG&E's recently announced plans to build new pipeline capacity, then we may order recalculation of marginal costs in other, more convenient proceedings so that the desired ratepayer protection against contract rate subsidies can be quickly implemented.

FINDINGS

1. No gas transportation contract for incremental loads should be approved unless the contract rate exceeds marginal cost or unless existing ratepayers are protected from the possibility that marginal cost will exceed the contract rate.

2. Presently the rates in both PG&E's Schedule G-COG and SoCal's Schedule GT-50 exceed marginal costs.

3. It is possible that during the term of the Mojave contract long run marginal cost will exceed either or both of those tariff rates.

4. The Mojave contract should be approved subject to the condition that if the Commission should ever find that long run marginal cost exceeds the contract rate, than the difference shall not be borne by existing ratepayers.

5. It is reasonable that the required ratepayer protection should be implemented in ACAP calculations, by assuming that contract revenues are based on the higher of the contract rate or adopted long run marginal cost.

6. Because conditional approval will protect existing ratepayers and for the reasons discussed above, DRA's protest should be denied.

THEREFORE, IT IS ORDERED that:

1. The long term gas transportation contract between Pacific Gas and Electric Company and Mojave Cogeneration Company which is the subject of Advice Letter 1522-G is approved, subject to the condition that if at any time during the term of the contract the contract rate should be less than Pacific Gas and Electric Company's adopted long run marginal cost of gas transportation, then shareholders shall bear the cost of the difference.

2. Unless revised by further order of the Commission, the above ratepayer protection shall be implemented in future Annual Cost Allocation Proceedings, by assumption that revenues from the contract shall be based on the higher of the contract rate or the adopted long run marginal cost of gas transportation services.

3. The Division of Ratepayer Advocates protest of Advice Letter 1522-G is denied.

4. This order is effective today, and Advice Letter 1522-G shall be so marked.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on May 10, 1989. The following Commissioners approved it:

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

Executive Director