PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2885
August 3, 1989

RESOLUTION

SOUTHWEST GAS CORPORATION. ORDER APPROVING AGREEMENT WITH LUZ DEVELOPMENT AND FINANCE CORPORATION FOR THE EXTENSION OF NATURAL GAS FACILITIES AND THE PROVISION OF NATURAL GAS SALES AND/OR TRANSPORTATION TO SOLAR ELECTRIC GENERATING PLANTS AT HARPER LAKE, CALIFORNIA.

BY ADVICE LETTER NO. 405, FILED JUNE 7, 1989.

SUMMARY

1. By Advice Letter No. 405, filed June 7, 1989, Southwest Gas Corporation (Southwest) requests approval of a Special Agreement (Agreement) with LUZ Development and Finance Corporation (LUZ) dated May 18, 1989. The Agreement provides for extension of a natural gas pipeline and associated facilities to LUZ's solar electric generating stations (SEGS) at Harper Lake, California, as well as gas sales and/or transportation services to LUZ's plants. The LUZ plants will generate electricity for sale to Southern California Edison Company (Edison).

2. This resolution approves the Agreement after finding that the Agreement will not disadvantage Southwest's other ratepayers.

BACKGROUND

1. Southwest and LUZ have agreed to terms for a pipeline extension and service of gas to LUZ's planned plants at Harper Lake. LUZ plans to build SEGS Units VIII, IX, X, XI and XII at the site. Each unit will have an electric capacity of 80 MW, selling power to Edison under Standard Offer 2 contracts. Gas service is expected to commence October 15, 1989 at SEGS VIII, with the remaining units coming on line at about one year intervals thereafter. Each unit can produce no more than 25% of its electric output from the burning of gas, in order to retain eligibility as a qualifying facility (QF) under Federal regulations. The remaining electricity is produced through collection of solar energy by large fields of parabolic mirrors.

2. Service by Southwest to the new LUZ units will require construction of a 7.5 mile pipeline from the Pacific Gas and Electric Company (PG&E) Line 300 to Harper Lake. Southwest's gas supply is now 100% from PG&E, a situation that will prevail at least through 1992, and likely for the five year term of the Agreement.

3. If LUZ were a small customer in Southwest's service territory, the new service might be made under existing line extension rules. However, the added gas loads of 7.7 million therms per year per SEGS unit will be a substantial increase over Southwest's present California throughput of 79 million therms per year. Because of the large load increase and because it is unlikely that the required line extension will serve other customers, Southwest invoked Rule 15.E.7, which requires negotiation of a special line extension contract, subject to Commission approval. The Agreement includes those terms, as well as terms for sale of gas and/or transportation services.

4. The projected cost of the new pipeline is $2.25 million, calculated at Southwest's current rate of return of 11.94%, authorized in Decision 88-12-081. Paragraph 12 of the Agreement provides that if the project cost differs from the projected $2.25 million, then the applicable gas rates to cover the pipeline construction will be recalculated using a computer spread sheet whose format is shown as Exhibit B attached to the Agreement.

5. Over and above the initial cost of the pipeline extension, each SEGS unit will require interconnection and metering facilities at a cost of approximately $250,000 per unit.

6. Under the terms of the Agreement, Southwest will construct, own and operate the new pipeline extension. The pipeline capital costs will enter Southwest's rate base, although such inclusion in rate base is not part of Southwest's request in Advice Letter No. 405. If the Agreement expires or is terminated before Southwest has recovered its full capital costs, then LUZ will reimburse Southwest for any undepreciated costs of the pipeline or additional facilities. Paragraph 19 of the Agreement explains those terms, which include provisions that the Commission must (1) find that the facilities are no longer used and useful, and (2) exclude the facilities from rate base.

7. The Agreement is structured so that LUZ pays Southwest's full costs of the pipeline extension and associated facilities, to be recovered through a flat rate of 2.2675 cents per therm over five years. LUZ may elect to continue the Agreement for a sixth year, with rate terms intended to cover Southwest's costs. If the capital costs of the new pipeline and facilities are recovered before the Agreement expires or is terminated, continued service to LUZ will be made at a reduced rate that is intended to cover Southwest's operating and maintenance expenses.

8. In addition to covering costs of the new pipeline and facilities, the Agreement includes terms for gas sales or transportation. If LUZ purchases gas from Southwest, the applicable rate will be Southwest's Actual Gas Cost Charge (AGCC), which is the monthly total system gas cost, including supplier demand costs and franchises, divided by total system sales volume. If LUZ transports its own gas over Southwest's system, the transportation rate will be the AGCC less the commodity cost of gas, including franchises.

NOTICE

1. Southwest has made public notification of this filing by mailing copies of Advice Letter No. 405 to other utilities, governmental agencies and all parties who requested such notification.

PROTESTS

1. The Commission Advisory and Compliance Division (CACD) has received no protests to Advice Letter No. 405.

DISCUSSION

1. CACD staff has reviewed the calculations of the rate intended to recover Southwest's costs for the pipeline extension and facilities at each SEGS plant. The calculations are made on a spread sheet that will be updated to include actual capital costs when the final figures are available. The spread sheet has the format of results of operations calculations routinely made by Commission staff. Four areas need further discussion:

2. First, depreciation expense is calculated over the pipeline and facility lifetime, which exceeds the term of the Agreement. This allows for the possibility of Southwest carrying undepreciated, and possibly unused, plant after the Agreement is terminated. Southwest's other ratepayers are protected against this burden by the terms of the Agreement, which place the burden on LUZ, so long as the Commission removes the undepreciated plant from rate base. CACD recommends that Southwest be ordered to notify the Commission when the Agreement expires or terminates.

3. Second, the rates to cover Southwest's costs are calculated at today's rate of return, without allowance for changing rate of return from year to year. This introduces a slight uncertainty about Southwest's actual recovery of costs, but CACD believes that use of the present rate of return is reasonable. CACD knows of no reason that increases in authorized rate of return are any more likely than decreases over the term of the Agreement.

4. Third, the rates are calculated at today's income tax rates. This also introduces uncertainty, but CACD believes that use of the present tax rates is reasonable.

5. Fourth, the rates charged to LUZ will depend on actual capital costs. A new Agreement will not be required, but the Commission should be informed of the eventual rates. For that reason CACD recommends that Southwest be ordered to update the rate calculations when data are available, and provide that information to the Commission.

6. The Agreement is structured so that Southwest will put the new pipeline and facilities into rate base, but Advice Letter No. 405 does not make that request. CACD assumes that Southwest will include the additional plant in service in subsequent attrition filings or other applications. The effective dates of the rate base additions should coincide with the effective dates of the rates to LUZ, but it is Southwest's burden to assure that.

7. In sum, CACD believes that the terms of the Agreement regarding the pipeline extension and facilities adequately protect other ratepayers. Remaining terms relate to sale or transportation of the gas itself.

8. If LUZ were to receive service under Schedule GN-2, the default cogeneration tariff, it would be contributing about 0.6 cents per therm to Southwest's margin. The current GN-2 rate is about 27.7 cents per therm, compared to 27.1 cents per therm for Southwest's current cost of gas (PG&E core cost of gas of 18.1 cents per therm plus 9.0 cents per therm PG&E wholesale transportation rate). However, that 0.6 cents per therm difference is not fixed for the term of the Agreement. It is very unlikely that the contribution to margin would cover the cost of the new pipeline and facilities, which is the reason Southwest invoked Rule 15.E.7.

9. As stated in Resolution G-2876, which conditionally approved a gas contract between PG&E and Mojave Cogeneration Company, "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 Agreement is also an incremental load contract.

10. For the PG&E-Mojave Cogeneration Company contract the risk to other ratepayers was that the contract transportation rates would not cover long run marginal costs. The present Agreement is simpler because Southwest purchases gas only from PG&E and because the term of the Agreement is relatively short. Southwest's sole source of gas supply is PG&E, continuing at least through 1992, with the possible exception of invocation of exchange agreements with Southern California Gas Company. No gas

covered by the Agreement will flow through any of Southwest's existing facilities, and the contract is therefore unlikely to cause a need for expansion of those facilities. Other ratepayers will not be at risk for subsidizing LUZ, the contract customer.

11. There remains the semantic distinction between holding other ratepayers harmless and making a net contribution to margin. The Agreement does not provide any contribution to the margin borne by other ratepayers, but it should generate secondary benefits. Southwest will gain a major new load, with assurance that its full costs will be covered. The increased system throughput should spread PG&E's upstream fixed costs over a larger volume, thus benefiting other ratepayers.

12. Because the costs of the pipeline extension and facilities will be covered, and because there should be a net benefit to other ratepayers, CACD recommends approval of the Agreement.

13. Southwest alleges, and CACD concurs, that Advice Letter No. 405 will not increase any rate or charge, conflict with other rate schedules or rules, or cause withdrawal of any service.

FINDINGS

1. Southwest's request for approval of the Agreement with LUZ, as well as the rates, charges and conditions of service contained in the Agreement are just and reasonable in that they provide service to the customer under terms mutually agreeable to both parties while protecting Southwest's other customers from undue burden.

2. Southwest's other ratepayers will benefit from the Agreement by spreading of gas supplier fixed costs over a larger total system gas throughput.

3. Advice Letter No. 405 does not request inclusion of the subject new pipeline and facilities into Southwest's rate base.

4. When the Agreement expires or is terminated Southwest should so notify the Commission, so that the Commission may consider opening an investigation into recovery of costs for any undepreciated plant or removal of operating and maintenance expenses from authorized revenue requirement.

5. When the rates and charges under the Agreement are revised to reflect the actual costs of the new pipeline and facilities, Southwest should notify the Commission of the revisions.

THEREFORE IT IS ORDERED that:

1. In accordance with the provisions of Public Utilities Code Sections 454 and 532, and Section X.A of General Order 96-A, the Special Agreement (Agreement) between Southwest Gas Corporation (Southwest) and LUZ Development and Finance Corporation (LUZ) dated May 18, 1989 that is the subject of Advice Letter No. 405 is approved.

2. The effective date of this approval is the effective date of this resolution, which constitutes more than regular statutory notice.

3. Within thirty (30) days after the effective date of this resolution, Southwest shall file revised tariff sheets to include the approved Agreement in its List of Contracts and Deviations.

4. Whenever the rates and charges under the Agreement are revised to reflect the actual costs of the new pipeline and facilities, Southwest shall within thirty (30) days so notify the Director of the Commission Advisory and Compliance Division (CACD). Such notice shall include all rates and charges in the Agreement, and recalculation of the computer spread sheets shown in Exhibit B attached to the Agreement.

5. When the Agreement expires or is terminated Southwest shall, within fifteen (15) days of the time that Southwest knows with certainty of such expiration or termination, so notify the Commission by letter to the Executive Director and the Director of the Commission Advisory and Compliance Division (CACD).

6. Advice Letter No. 405 and the accompanying Agreement shall be marked to show that they were approved for filing by Commission Resolution G-2885.

7. This resolution is effective today.

I certify that this resolution was adopted by the Public Utilities Commission at its regular meeting on August 3, 1989. The following Commissioners approved it:

Executive Director

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