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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2932
December 19, 1990

RESOLUTION

RESOLUTION G-2932. PACIFIC GAS AND ELECTRIC COMPANY REQUESTS AUTHORITY TO IMPLEMENT FIVE LONG TERM GAS TRANSPORTATION CONTRACTS WITH LUZ SOLAR PARTNERS III THROUGH VII. BY ADVICE LETTER 1609-G, FILED SEPTEMBER 13, 1990.

SUMMARY

1. By Advice Letter 1609-G, filed September 13, 1990, Pacific Gas and Electric Company (PG&E) submitted for approval negotiated long-term gas transportation agreements with Luz Solar Partners III through VII (Luz). Since the agreements are identical, and were negotiated as a unit, PG&E requested that the Commission consider them as a single package.

2. This resolution rejects the contracts without prejudice.

BACKGROUND

1. Decision 86-12-009 requires that all non-core gas transportation agreements with a term of 5 years or more be submitted to the Commission for approval. The Luz contracts, submitted by PG&E under Advice Letter 1609-G, would provide gas transportation for an initial period of 15 years to five solar energy generating stations (SEGS III - VII) located in the Mojave Desert at Kramer Junction, San Bernardino County, California.

2. The five Luz facilities covered under this Advice Letter are located at the junction of the proposed Kern River and Mojave interstate pipelines. In 1989, Luz requested a long-term contract with PG&E; without it, Luz stated that it would bypass the PG&E system by contracting for capacity on one or both proposed pipelines. The advice letter includes an affidavit from one of Luz' vice presidents, stating that Luz has discussed rates, terms, and conditions of gas transportation with the proponents of several interstate pipelines, and that absent the contracts with PG&E, Luz will seek to obtain service from one of the interstate pipeline projects that may be constructed.

3. SEGS III - VII are all operational, and are receiving service under PG&E's G-COG schedule for cogenerators, which currently stands at $0.07536 per therm. The proposed Kern River and Mojave pipeline transportation rates range from approximately $0.036 to $0.06 per therm.

4. PG&E has supplied Luz' transportation volumes for SEGS III-VII since 1987. The five units transported a total of 18,619,000 therms in 1989. PG&E estimates that under the contracts, the SEGS units would use more than 20 million therms per year.

5. Luz sells the electrical output of its SEGs to Southern California Edison (Edison). To retain parity with the price that Edison pays for transportation of its gas, the contracts offer a transportation rate based on Southern California Gas Company's (SoCal) rate schedule GT-50 for cogenerators, currently $0.07475 per therm. PG&E states this is necessary to be consistent with the rate parity provisions of P.U. Code Section 454.4.

6. The contract rate for gas transportation will be adjusted based on factors applicable to the "Index Period" and the "Discount Period." The Index Period begins on the effective date of the contracts and continues until the new interstate natural gas pipeline that would have been connected directly to Luz becomes operational. During the Index Period, the contract rate will be weighted to give Luz an incentive to switch loads to the summer months (March 1 - November 30). During the Discount Period, which will occur only if a new interstate pipeline becomes operational, the gas transportation rate will be discounted by approximately 7 percent from SoCal's GT-50 rate. The rates will be as follows:

<u>Index Period:</u>
Summer Rate: Base Rate x 0.932
Winter Rate: Base Rate x 1.206

<u>Discount Period:</u>
Rate: Base Rate x 0.932

7. Based on SoCal's current GT-50 rate, PG&E estimates that the agreements will generate $1.5 million per year, for a total of $15.7 million in present value over the full 15 years of the contracts. If the Discount Period begins in the third year of the contracts, total revenues will be $14.2 million. According to PG&E, the marginal cost of serving Luz over the full 15 years of the contracts is $7.5 million in present value.

8. Exhibit A of the contracts provides a long-run marginal cost floor for contract rates.

9. Under Federal Energy Regulatory Commission (FERC) rules for solar thermal qualifying facilities (QFs), Luz may use natural gas for up to a maximum of 25 percent of its input energy requirements. Exhibit B of the contracts specifies an annual 75 percent take-or-pay clause for this maximum amount of natural gas.

10. Exhibit C will contain operating data on estimated and actual customer use, Luz' broker, supplier, and the pipeline that transports its gas.

11. Exhibit D of the contracts specifies the termination charges. Luz may terminate the contracts upon the expiration of the first five years, or after the first ten years. Luz must pay PG&E $100,000 for each year remaining from the termination date until the end of the full 15-year initial term of the contract.

12. Paragraph 14 of the contracts allows Luz a one-time option to return to the PG&E rate schedule that would otherwise be applicable to the facilities. If Luz exercises the option, it will continue to be subject to the take-or-pay clause.

13. PG&E requests that the Commission waive the following provision of General Order (GO) 96-A, Sections IX and X.A, "This contract shall at all times be subject to such changes or modification by the Public Utilities Commission of the State of California as said Commission may, from time to time, direct in the exercise of its jurisdiction." PG&E believes this is necessary to ensure Luz' commitment to the long-term contract and prevent bypass.

14. According to PG&E's Rule 14, the priority for the gas transported under the Luz contracts will be P-3A.

NOTICE

1. Advice Letter 1609-G was noticed in the Commission Calendar on September 17, 1990, and was mailed to all parties on PG&E's gas advice letter mailing list in accordance with GO 96-A.

PROTESTS AND RESPONSES

1. Toward Utility Rate Normalization (TURN) and the Division of Ratepayer Advocates (DRA) filed separate protests to Advice Letter 1609-G on October 3, 1990. PG&E responded to both protests on October 10, 1990, and addressed each of the issues raised by TURN and DRA. Luz also submitted a response to DRA and TURN. The response contained additional support for PG&E's arguments on the issues of parity with SoCal rates, applicability of the cogeneration rate, rate discounts, bypass viability, and the waiver of GO 96-A.

2. <u>Parity with SoCal's UEG Rate:</u>

TURN is unconvinced that Section 454.4 requires PG&E to offer Luz a rate equal to that charged by another gas utility to the electric utility that will purchase electricity from Luz. At the same time, TURN recognizes that the Commission has approved contracts with similar terms in D.89-10-034 and D.88-12-081.

DRA contends there is no legal requirement to provide the SoCal cogeneration rate to Luz. DRA states that PG&E made the same argument in Advice Letter 1522-G, related to the Mojave Cogeneration Company, but the Commission based its decision on the basis of potential bypass.

PG&E responded by stating that it interprets P.U. Code Section 454.4 to mean that Luz is eligible for the same transportation rate that Edison pays to SoCal. Edison pays Luz for energy based in part on the price Edison pays for gas transportation. PG&E stated that in accordance with Section 454.4, it follows that for Luz to pay a rate "not higher than the rates established for gas utilized as a fuel by an electric plant," the equivalent SoCal UEG rate would be an appropriate index. PG&E noted that its interpretation of Section 454.4 is consistent with DRA's position in its protest against the Mojave Cogeneration contract (Advice Letter 1522-G).

<u>Discussion:</u> The Commission Advisory and Compliance Division (CACD) has researched the issue, and found that the Commission has twice adopted cogeneration rates that are based on the gas rate of the local utility that purchases the cogenerator's output. The first instance was Southwest Gas' general rate case, D. 88-12-081. In that case, Southwest's cogeneration gas rate was set at parity with the SoCal gas UEG rate, reflecting the fact that cogenerators in Southwest's California service territory sell their power to Edison. The second example was the gas transportation contract between Mojave and PG&E, which was approved in D.89-10-034. DRA's protest to that contract (Advice Letter 1522-G) stated that the legislative mandate of Section 454.4 would be satisfied by a contract that offered the same rate paid by the cogenerator's electric customer. Therefore, CACD concludes that the Commission has already established a precedent for approving gas transportation rates at parity with the rates paid by the cogenerator's electric customer.

3. <u>Prevention of Bypass:</u>

TURN does not believe the contracts will prevent bypass because Luz can terminate after five or ten years, subject to a termination fee. TURN states that although the anti-bypass discount rates take effect only when a new pipeline is built,

there is nothing to prevent Luz from demanding further discounts at the end of five years if a new interstate pipeline is operating at that time.

PG&E responded that the termination charges of $1,000,000 at five years and $500,000 at ten years are consistent with the charges approved by the Commission in the Mojave cogeneration agreement. Further, PG&E argues that the termination fees are higher than Luz would pay under existing tariffs, which waive all termination charges if Luz provides 12 months advance notice. PG&E claims that its ratepayers would receive more compensation under the contracts than would be available under standard tariffs.

Discussion: CACD has reviewed the termination provisions, and has found that the termination payments are similar in size to those approved in the Mojave contract. The $1 million payment after five years is likely to be much greater than the cumulative amount of any discounts that Luz might realize over the first five years of the contract. An interstate pipeline would have to offer Luz a significant discount below the contract rate in order to convince Luz to terminate service from PG&E. In addition, the Commission would have to approve any further discounts or long-term contracts between PG&E and Luz. Last, if Luz were to continue to receive service at PG&E's G-COG rate, it would only have to provide 12 months notice before switching to interstate pipeline service, and then would not be liable for termination charges. Because the Commission has already approved charges of this magnitude in the Mojave contract, and because of the benefits to ratepayers over regular service at the G-COG tariff, CACD believes that the termination charges in the proposed contracts appear reasonable.

4. Waiver of GO 96-A:

TURN opposes the waiver of the Commission's authority in GO 96-A to alter the contracts. TURN states that such waivers are all too likely to come back to haunt the Commission and ratepayers in the future.

DRA opposes the waiver of GO 96-A because of the possibility that neither interstate pipeline will be built. DRA notes that these contracts and others like them reduce the possibility of construction of either the Kern or Mojave pipelines. DRA states that the waiver of GO 96-A could allow Luz to receive a discount long after any credible threat of bypass has gone.

PG&E responded that Luz' long-term bypass alternative, the proposed interstate pipelines, would not be subject to any changes directed by the Commission. PG&E argues, therefore, that Luz should be allowed the same treatment in an agreement with PG&E, and GO 96-A provisions should be waived. Further, PG&E

claims that such treatment is consistent with Commission actions on long-term Enhanced Oil Recovery (EOR) contracts and the Commission's settlement with WyCal. PG&E states that the benefits of retaining Luz as a PG&E customer outweigh the potential risk to ratepayers of waiving GO 96-A Sections IX and X.A.

Discussion: Although the Commission has waived GO 96-A for service to the EOR market, no such waiver was granted for the Mojave contract. Further, D.90-09-089 states that "Regulatory change is a risk that all parties face, including those who sign long-term contracts. We would be ignoring our obligations if we forestalled required regulatory changes on the basis that a handful of customers have signed long-term contracts that might be affected" (p. 57). Given the uncertainty surrounding the actual completion of a competing interstate pipeline, CACD recommends that the Commission should not waive its authority under GO-96A to modify the Luz contracts.

5. Customer Charges:

TURN believes there is some ambiguity regarding customer charges to be paid by Luz. The ambiguity arises in Exhibit A of the contracts, which sets the rate equal to the average of all "Avoidable Transmission Charges" for UEG customers on SoCal's system. The Commission has determined that customer charges are not avoidable for purposes of QF pricing, but TURN states that the current SoCal GT-50 rate ($0.07475 per therm) appears to include customer-related costs (D.90-01-015). According to TURN, the Commission should clarify whether Luz will be paying the SoCal UEG per-unit customer charge, the PG&E customer charge, or no customer charge at all.

PG&E did not respond to this issue.

Discussion: CACD reviewed SoCal's GT-50 and GT-60 rate schedules and PG&E's G-COG and G-UEG schedules. Under the proposed contracts, Luz would pay the volumetric rate specified in SoCal's GT-50 tariff. The GT-50 rate fluctuates, as it is based on the average rates paid under GT-60 by UEG customers for the two months prior to the current month. The average includes all transmission charges, including demand charges. There is no customer charge in the GT-60 tariff; therefore, Luz would not pay a customer charge.

PG&E's G-COG rate is based on the weighted average transportation rate paid by PG&E's steam electric plants. Those plants are charged under the G-UEG tariff, which contains a customer charge of $96,136 per month. The weighted average transportation charge paid by PG&E's cogenerator customers thus includes a customer charge.

The absence of customer charges in the rates to be paid by Luz under the proposed contracts results in an additional benefit to Luz in comparison with PG&E's other cogeneration customers.

6. Option to Return to PG&E's G-COG Rate:

DRA contends that the parity requirements of P.U. Code Section 454.4 do not extend to allowing Luz to return to the PG&E rate at some future time, as provided in paragraph 14 of the contracts.

PG&E responded that if Luz were to exercise the option to return to PG&E's G-COG tariff, it would pay undiscounted G-COG rates for the remaining term of the contracts while continuing to be liable for both the 75 percent take-or-pay and termination clauses. PG&E asserts that both clauses are more beneficial to ratepayers than standard terms.

Discussion: CACD determined that the option to return to PG&E's G-COG rates benefits ratepayers in that Luz would continue to be liable for the termination charges and take-or-pay provisions of the contracts, and would pay the full tariffed rate.

7. Whether Luz is Entitled to the Same Rates as Cogenerators:

DRA states that P.U. Code Section 454.6 gives solar generators the same discounted rates as cogenerators, but that SEGS III-VII are not entitled to the discount. According to DRA, solar electric generators must have a natural gas efficiency rate of 60 percent or more to qualify for the discount. DRA interprets this to mean that at least 60 percent of the energy in the gas consumed must be converted to electrical energy; a standard that earlier Luz plants were able to meet. But DRA states that SEGS III-VII possess gas-fired steam boilers, which make it thermodynamically impossible to convert more than 35 percent of the energy in natural gas to electricity.

PG&E responded that "a more reasonable interpretation" of P.U. Code Section 454.6 is that it requires solar generating units to have a fuel-to-steam efficiency of more than 60 percent. Luz' Executive Vice-President, Ted Cooke, attested that the efficiency of SEGS III-VII exceeds 80 percent, which meets and surpasses the requirements for eligibility under the PG&E G-COG tariff.

Luz responded that DRA's impression of the superior efficiency of SEGS I and II is erroneous. According to Luz, SEGS II uses a separate gas-fired boiler in the same configuration as SEGS III-VII. DRA's protest apparently refers to SEGS I, which, unlike later SEGS projects, employs a gas-fired superheater to superheat the saturated steam which the SEGS I solar field

produces. Luz has not used this configuration on subsequent units because of its inefficiency. Luz further discussed thermal efficiencies of the superheater and the boilers, and concluded that the relevant natural gas efficiency rate condition in Section 454.6 is the efficiency with which the boilers convert natural gas BTUs to useful thermal energy (steam).

Discussion: Luz' earlier units, SEGS I and II, met the efficiency criteria for natural gas utilization; DRA, PG&E, and Luz agree on this point. Luz states that it has improved the efficiency of subsequent projects, and provides affidavits to that effect from Dr. David Kearney, Luz Vice President of Development and Finance. Since the earlier units qualified on the basis of a 60 percent efficiency interpretation, and SEGS III - VII are more efficient than the earlier units, CACD concludes that SEGS III - VII must also qualify for the G-COG rate as specified in P.U. Code Section 454.6. But if SEGS III - VII prove to be less efficient than earlier units, the contract fails.

8. Accuracy of PG&E's Marginal Cost Estimates:

DRA argues that PG&E's marginal cost showing understates the actual marginal costs of serving Luz. According to DRA, PG&E excluded the variable cost component of marginal transmission and storage and the marginal customer costs. DRA claims that PG&E determined incorrectly that local transmission costs would not apply to Luz. In addition, DRA states that the Present Worth method, upon which PG&E based its marginal cost calculations, has been ill defined and is inconsistent with the same method as PG&E proposed it in I.86-06-005, the Commission's gas rate design investigation.

PG&E disagrees with DRA's assertion that the marginal costs used in the Luz contracts are incorrect, and states that the inclusion of a long-run marginal cost price floor in paragraph 10 will ensure the agreements are fair to ratepayers, as required by D.89-10-034. In addition, PG&E asserts that variable costs were excluded because the data were not available when the contract was negotiated. Subsequent analysis showed that variable costs are small in relation to capital costs, and that exclusion of the variable costs does not constitute the more than $8 million difference between revenues and marginal costs. Further, PG&E asserts that excluding local transmission costs is appropriate for Luz, since Luz is served from Line 300, which is part of PG&E's backbone transmission system.

PG&E contends that the Present Worth Method is identical to that which PG&E presented in workshops for I.86-06-005. The marginal costs used for contract analysis are based on multi-year investment plans. The calculation considers each investment

individually, and the total marginal cost over the contract period is the sum of the cost of deferring the individual investments.

Discussion: DRA pointed out, and CACD agrees, that it is inappropriate to litigate marginal costs in an advice letter. The Commission has not yet adopted a long-run marginal cost for PG&E, which makes it impossible to review PG&E's marginal cost submissions in this advice letter. Further, because the long-run marginal cost proceeding, I.86-06-005, has been delayed, it may be some time before PG&E's marginal costs are known.

9. Costs of Capacity Expansion:

According to DRA, PG&E failed to include the total cost of all capacity expansion projects that will be built while the contracts are in force. PG&E included only the costs of capacity on the proposed Wyoming-California (WyCal) pipeline and Pacific Gas Transmission (PGT) expansion projects, although the 1990 California Gas Report calls for significantly greater capacity need on the PG&E system. DRA stated that PG&E has already signed an agreement with Transwestern Pipeline System (Transwestern) for capacity on its proposed San Juan expansion of at least 200 mdth/day. The cost of this capacity is not included in PG&E's calculations.

At the time of the analysis, PG&E states that it had only commitments to the WyCal and PGT capacity expansions, and that DRA's discussion of a precedent agreement signed by PG&E for additional capacity on the Transwestern expansion has no bearing on the Luz contract. The Luz agreement was signed in June, while the Transwestern agreement was not signed until September 1990. PG&E asserts that inclusion of the Transwestern expansion still results in positive benefits to ratepayers.

PG&E notes that its marginal cost estimates are consistent with data in the 1988 California Gas Report and PG&E's 1989 Marginal Cost filing. PG&E claims it is not possible to tie the marginal cost estimates used in the analysis of the Luz contract to capacity needs disclosed in the 1990 California Gas Report.

DRA states that the tariff sheets included in the initial filing for the PGT expansion (A. 89-04-033) indicate that the average rate on that expansion would be approximately $.75/mcf in 1988 dollars. DRA claims that, even excluding marginal storage and variable costs, PG&E's marginal costs appear to be greater than the rate being offered Luz.

In response to DRA's claim that marginal costs for the PGT expansion are greater than the rates being charged to Luz, PG&E asserts that it has complied with D.90-07-055 in the Gas Long-Run Marginal Costs OII. Specifically, that decision states that the

estimated cost of new capacity should serve as a proxy for determining long-run marginal costs for interstate capacity.

Discussion: As stated above in the discussion of item 8, the Commission has not yet adopted marginal costs for PG&E. Clearly the costs of system expansions will alter PG&E's marginal costs. Until the Commission's program for long-run marginal costs is in place, CACD cannot evaluate the varying claims about the accuracy of the marginal costs of capacity expansion included in this advice letter.

10. Standards for Anti-Bypass Contracts

DRA argues that the proposed contracts fall short of the standard for long-term anti-bypass contracts specified in D.89-12-045. Because no pipelines have yet been built, DRA states that there is no current possibility of bypass.

PG&E stated that Luz' proximity to the proposed interstate pipeline routes provides a persuasive argument for Luz' ability to bypass. PG&E added that the proposed contracts gave Luz the incentive not to invest in bypass facilities. Further, if Luz were to make any investment to bypass the PG&E system by committing to either pipeline, PG&E would be precluded from negotiating with Luz. PG&E adds that if the pipelines are not built, Luz will not receive any discount.

Discussion: In D.89-10-034, the Commission approved a similar contract with Mojave Cogeneration Company, which is also located near the proposed interstate pipelines. In approving that contract, the Commission clearly accepted the viability of a bypass threat that relies on future completion of one of the proposed interstate pipelines.

11. Discounts

DRA states that although PG&E claims Luz would receive no discount until a bypass pipeline is built, that is not the case. DRA argues that the differential between PG&E's and SoCal's tariffed rates is $0.040 per therm, which amounts to an unjustified discount because there is no credible bypass threat at this time.

According to DRA, the proposed contracts fail to meet the standards set forth in D.89-10-034, which states that the primary requirements for contract approval are convincing showings that ratepayer benefits exist and that no better deal is possible for ratepayers. DRA contends the contracts do not meet this test since they offer discounts prior to the construction of a credible bypass threat.

DRA states that without the contracts PG&E could discount rates to Luz on a short-term basis as allowed in D.87-12-039, but the company would remain at some risk for its actions in reasonableness reviews. Further, DRA argues that if the contract rates will not cover the cost of service, then PG&E's shareholders should remain at risk for possible revenue shortfalls.

PG&E refutes DRA's argument that the SoCal UEG rate represents a discount from PG&E's G-COG rate. PG&E included a two-year comparison of its G-COG rate with SoCal's GT-60 (UEG) rate, which shows that the two rates have been nearly identical. SoCal's GT-60 rate was used in the analysis rather than the GT-50 (cogenerator) rate because curtailments on the SoCal system triggered the "otherwise applicable rate" provision of the GT-50 rate during the winter months. PG&E stated that using the lower GT-60 rate provides a "conservative" comparison and an overall lower rate than would have been applicable under GT-50.

Discussion: The proposed contracts would provide Luz with a transportation rate based on SoCal's cogeneration rate, known as GT-50, which presently stands at $0.07475 per therm. PG&E's G-COG rate, under which Luz now receives service, stands at $0.07536 per therm. DRA is incorrect in its assertion that PG&E's current rate is $0.115 per therm. The SoCal UEG rate is $0.00061 per therm less than PG&E's. Further, the contract rate would be seasonally adjusted with a 20 percent surcharge for winter use, when Luz has historically used about 40 percent of its natural gas. At the current rates, if Luz were to transport an annual volume of 20 million therms, its total discount from PG&E's G-COG rate would be $50,000.

The contracts would offer Luz a discount of 6.8 percent from SoCal's cogeneration rate, but not until the Discount Period, when one of the proposed interstate pipelines is in service.

DISCUSSION

1. CACD reviewed the advice letter for compliance with Commission policies and previous decisions on anti-bypass contracts.

2. Decision 89-12-045 provides guidance on the Commission's policies on long-term contracts. The purpose of long-term contracts is to encourage the utilities to attract incremental load that might otherwise be lost (p. 7). Further, the Decision states, "...long-term contracts are appropriate under certain circumstances. They are primarily useful where a customer must make a decision regarding whether or not to invest in bypass facilities and such facilities would clearly result in uneconomic bypass" of the utility (p. 20).

3. Uneconomic bypass occurs when a customer leaves the utility system even though the customer's alternative energy source costs more than the marginal cost of utility service. That is, ratepayers could receive some positive contribution from the potential bypasser by offering a rate less than or equal to the bypass cost, but still higher than the utility's marginal cost.

4. Decision 89-10-034 set forth information requirements and guidelines for approval of special sales contracts. Specifically, the decision requires the utility to support requests for contract approval with sufficient data to judge whether or not ratepayer benefits would result from the contract. The calculation of ratepayer benefits must explicitly consider the uncertainties of bypass credibility and marginal cost forecast accuracy. Special contracts should be approved unconditionally if the likelihood of substantial benefits over the life of the contract greatly outweighs the risk of subsidies paid by ratepayers. If no such benefits are demonstrated, the Commission may conditionally approve the agreements.

5. D.89-12-045 and D.89-10-034 outlined the criteria for review of anti-bypass contracts. First, the utility must support the credibility of the customer's bypass threat. Second, the utility must demonstrate that bypass would be uneconomic for ratepayers as a group. And third, the utility must show that the agreement provides substantial ratepayer benefits and that no better deal is possible for ratepayers.

6. The first question to ask is whether PG&E has demonstrated that Luz has a viable uneconomic bypass threat. PG&E and Luz argue that these contracts are necessary to prevent Luz from negotiating with one of the proposed interstate pipelines for transportation service. Proposed tariffs for the PGT and WyCal pipelines would offer transportation service at a rate of four to six cents per therm, which is less than PG&E's current G-COG tariff rate of 7.536 cents per therm. At the same time, PG&E clearly expects that the pipelines will not be in operation for at least two years. This expectation is apparent in Table IV of the advice letter. The table presents PG&E's estimate of contract revenues, and the Discount Period begins in the third year of the Luz contracts.

7. The second question is whether the threatened bypass would be uneconomic to ratepayers. This question is difficult to answer in this case because PG&E's marginal costs have not yet been determined, even though PG&E did provide an estimate of what it views to be its marginal cost in its filing. Luz' bypass options would clearly cost less than tariffed service on a volumetric basis, but it is unclear whether bypass would be more than PG&E's marginal cost of service. If the cost of the bypass service would be less than PG&E's marginal cost, Luz should bypass PG&E's system.

8. The third question for review of anti-bypass contracts is whether the utility negotiated some contribution to margin that benefits ratepayers. In this case, the proposed contracts include a marginal cost floor, and a 75 percent take-or-pay clause that would assure stable revenues for the contract period.

9. By Resolution G-2876, passed on May 10, 1989, the Commission approved a similar long-term transportation contract between PG&E and Mojave Cogeneration Company. Like Luz, Mojave is located near the proposed interstate pipelines, and sells its electric output to Edison. As amended by D.89-10-034, the Mojave contract was approved unconditionally, and provides Mojave with the lower of SoCal's GT-50 or PG&E's G-COG rates. The Commission stated that although we do not know with certainty PG&E's marginal costs, the record of D.85-12-102 reasonably assures that these rates will exceed current long-run marginal costs. Further, by approving that contract, the Commission clearly believed that PG&E had demonstrated the viability of Mojave's bypass threat. Last, the Commission found that the ratepayer benefits of the long-term contract outweighed the risk that the contract rate would be below PG&E's marginal cost of serving Mojave.

10. In D.90-02-016, dated February 7, 1990, the Commission stated that it would support any interstate pipeline project that met specified conditions, and would allow market forces to determine which pipeline(s) would actually be built. "We see clear indications that with the specific guidance we have given in this decision, competitive forces will induce the pipeline project sponsors, the utilities, and the potential customers for such pipelines to reach agreement on new projects which will benefit the economy of the entire state. Our desire to facilitate the speedy construction of new pipeline capacity and our desire to avoid the economic consequences of bypass need not be mutually exclusive" (p. 113).

11. CACD researched the amount of available capacity on the proposed interstate pipelines, and found that neither Kern, PGT, or Mojave pipelines have capacity available to serve Luz. In fact, all three proposed pipelines are fully subscribed or have contracts covering all their available capacity. Without the PG&E contracts, Luz could obtain capacity on a pipeline from one of the customers with service agreements, but this is exactly the kind of market activity that the Commission desires in the new regulatory framework for gas, and it should not be preempted by long-term contracts signed before the new capacity is available.

12. The contracts for Luz would provide a single customer with the benefit of firm capacity. PG&E has provided no showing in its advice letter that it has offered this type of contract to others similarly situated on a not unduly discriminatory basis. We believe that contracts such as these should be available equally to all customers on an open and nondiscriminatory basis.

13. As pointed out in Resolution G-2930, which addresses another PG&E anti-bypass contract with C&H Sugar, PG&E has forecast curtailments of approximately 29,774 mdth for noncore and core-elect customers in its current ACAP (A.90-08-029). PG&E has made no showing in this filing that it has excess capacity requiring discounts to retain large loads. Long-term contracts are inappropriate under system constraints, but the capacity brokering program and new interstate pipeline(s) will help alleviate the capacity shortage in late 1991 or early 1992, at which time long-term contracts may again be necessary to retain incremental loads.

14. Approval of these contracts may prejudge the outcome of the capacity allocation proceeding, R.88-08-018, in which evidentiary hearings begin in February 1991. By Resolution G-2921, dated July 6, 1990, the Commission rejected more than a dozen long-term contracts submitted by SoCal on the grounds that approval of the contracts could prejudice the outcome of the capacity allocation and procurement proceedings.

15. The advice letter should be rejected without prejudice so that PG&E may resubmit the contracts, with additional supporting documentation as follows. In subsequent filings, PG&E (or any other utility) must submit evidence that the bypass pipeline has sufficient capacity available to serve the customer. In addition, the utility must demonstrate that the contract(s) in question do not interfere with the market forces necessary to develop additional interstate pipeline capacity.

FINDINGS

1. The proposed Luz contracts would provide stable revenues to PG&E, ensured by the 75 percent take-or-pay provision. As soon as one of the proposed interstate pipelines is operating, Luz would receive a 6.8 percent discount from the SoCal GT-50 rate. The marginal cost floor price provision would ensure that other ratepayers would not subsidize Luz.

2. The Commission has established a precedent under D.88-12-081 and D.89-10-034 for approving gas transportation rates at parity with rates paid by the cogenerator's electric customer.

3. The termination charges in the proposed contracts provide benefits to ratepayers and appear reasonable.

4. Given the uncertainty surrounding the actual completion of a competing interstate pipeline, the Commission should not waive its authority under GO-96A to alter the Luz contracts.

5. Luz will not pay customer charges under the contracts, which is an additional benefit to Luz in comparison with PG&E's other cogeneration customers.

6. The option for Luz to return to PG&E's tariffed cogeneration rates, if executed, would benefit ratepayers.

7. Luz qualifies for the cogeneration rate as specified under P.U. Code Section 454.4 because SEGS III - VII appear to be more efficient than earlier units that qualified. If this should not be the case, the contracts should fail.

8. Because the Commission has not yet adopted long-run marginal costs for PG&E, it is not possible to determine whether PG&E's marginal cost calculations for this contract are correct.

9. Without the Commission's program for long-run costs, it is not possible to evaluate the claims about PG&E's costs of capacity expansion.

10. The Commission has accepted as viable the threat of bypassing by connecting directly to one of the proposed interstate pipelines.

11. The PG&E-Mojave Cogeneration Company contract, approved by D.89-10-034, establishes some precedents that are applicable to this advice letter. First, the Commission accepted that the proposed pipelines constitute a viable uneconomic bypass threat. Second, cogenerators that sell their electric output to Edison are entitled to SoCal's cogeneration gas rate, even if the cogenerator purchases its gas from another utility. And third, the ratepayer benefits to be gained from a long-term contract

with stable revenues outweigh the risk that the discounted rate might be less than PG&E's marginal cost.

12. D.89-12-045 and D.89-10-034 set forth Commission policy that no anti-bypass transportation contracts should be approved unless the customer has a viable opportunity to invest in bypass facilities that would clearly result in uneconomic bypass. Further, the utility must demonstrate that the contract provides ratepayer benefits and that no better deal is available for ratepayers.

13. In D.90-02-016, the Commission set forth its policy on new interstate pipelines. Competitive market forces should determine which proposed pipeline(s) will be built.

14. The proposed interstate pipelines are fully subscribed.

15. Contracts providing a customer with firm capacity should be offered to all customers similarly situated on an open and nondiscriminatory basis.

16. Long-term contracts are inappropriate in situations of constrained capacity.

17. Approval of the Luz contracts or other long-term contracts could prejudice the outcome of the capacity allocation proceeding currently before the Commission.

18. Requests for approval of anti-bypass contracts should include evidence that sufficient capacity is available on the bypass pipeline to serve the customer, and that the contracts do not prejudice the development of the market for capacity on the proposed interstate pipeline(s).

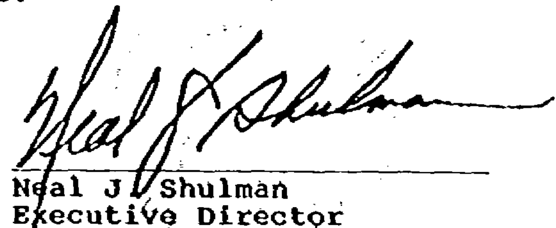
THEREFORE, IT IS ORDERED THAT:

1. The long-term gas transportation contracts between PG&E and Luz Solar Partners III through VII, which are the subject of Advice Letter 1609-G, are rejected without prejudice.

2. This order is effective today, and Advice Letter 1609-G shall be so marked.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on December 19, 1990. The following Commissioners approved it:

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



Neal J. Shulman
Executive Director