PACIFIC GAS AND ELECTRIC COMPANY

CHAPTER 1

INTRODUCTION AND POLICY

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PACIFIC GAS AND ELECTRIC COMPANY
CHAPTER 1
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A. Introduction

In this application, Pacific Gas and Electric Company (PG&E) requests authority from the California Public Utilities Commission (CPUC or Commission) to establish an Economic Development Rate (EDR) that is specifically tailored to address varying economic conditions in the Company's service area. PG&E's current EDR, Schedule ED, is set to close to new customers at the end of 2012. PG&E is submitting the current proposal as a replacement for Schedule ED.

PG&E's EDR proposal is designed to enhance California's competitiveness as a business location for companies to create or retain jobs for California residents. PG&E's EDR proposal will help local, regional and state economic development partners to retain their economic base and compete with other states in attracting or retaining qualifying businesses; increase the Company's flexibility to support the needs of California communities and respond to local economic conditions; and thereby provide more certainty for all PG&E's customers.

The purpose of this chapter is to provide the regulatory background and economic conditions leading up to this application, and to introduce the overall objectives and time-sensitivity of PG&E's EDR proposal.

B. Regulatory Background

In 2004, Southern California Edison Company (SCE) and PG&E filed Applications 04-04-008 and 04-06-018, respectively for the adoption of EDRs. The Commission consolidated the two applications and, at the request of the presiding Administrative Law Judge, SCE and PG&E submitted a joint proposal for an EDR, compromising on various aspects of their independent proposals. The Commission adopted this joint proposal, with certain amendments, in Decision 05-09-018. The adopted rate included an enrollment cap of 100 megawatts, a sunset date of December 31, 2009 (i.e., no new contracts were to be executed after this date) and a 5-year declining discount schedule of 25-20-15-10-5 percent. In order to be eligible for the EDR, the customer must

sign an affidavit attesting to the fact that "but for" this incentive rate, either on its own or in combination with a package of incentives made available to the customer from other sources, the customer would not have: (1) located operations or added load within the state of California; or (2) retained load within the state of California.

In Decision 05-09-018, the Commission also established a price floor below which any EDR customer's revenues could not fall. Subsequently, the Commission revised this price floor through a series of decisions.**[1]** Beginning in 2007, the price floor consisted of distribution marginal cost, generation marginal cost, transmission revenue, public purpose program charges, nuclear decommissioning charges, Department of Water Resources (DWR) Bond charges and Competition Transition Charges.**[2]**

In late 2009, SCE and PG&E filed Applications 09-10-012 and 09-11-010, respectively to extend the EDRs, which were then set to close for new applicants at the end of 2009. In December 2009, the Commission's Executive Director extended SCE's and PG&E's EDRs so as not to expire on December 31, 2009, pending final decisions on Applications 09-10-012 and 09-11-010.**[3]**

In late April 2010, SCE, PG&E, the Division of Ratepayer Advocates, The Utility Reform Network and the Energy Users Forum executed a settlement agreement that these parties filed with the Commission on May 3, 2010. In Decision 10-06-015, the CPUC adopted the settlement agreement which, for each utility, extended the sunset date to December 31, 2012 and revised the incentive (for new contracts) from the 25-20-15-10-5 percent schedule to a maximum 12 percent per year for five years.

C. Economic Conditions in California Justify PG&E's EDR Proposal

In Decision 05-09-018, the Commission found that: (1) electricity is a major cost of doing business in California;**[4]** (2) the EDR program lowers rates for all

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[1] See Decisions 05-09-018, 06-05-042, 07-09-016, and 07-11-052.

[2] See Decision 07-09-016, as modified by Decision 07-11-052. Note that the Energy Cost Recovery Adjustment is also assumed to be included in the floor price.

[3] The Executive Director provided these extensions by letter dated December 9, 2009 (for PG&E) and December 23, 2009 (for SCE).

[4] D.05-09-018, p. 10.

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ratepayers by increasing or retaining revenues that contribute to utilities' fixed costs;**[5]** and (3) the EDR program provides indirect benefits to ratepayers by increasing local employment opportunities and economic vitality.**[6]** The Commission reiterated these findings in Decision 10-06-015.

1. Economic Conditions in California Have Not Substantially Improved Since Decision 10-06-015 Was Adopted

California continues to suffer from extremely high unemployment. Since the onset of the Great Recession in December 2007, California has lost 1.1 million jobs, or about 7 percent of its employment base. Manufacturers have been even harder hit, losing approximately 248,000 jobs out of a total of 1,459,000, meaning that 17 percent of all manufacturing jobs in the state have disappeared in the last four years.

The recession hit California hardest. The Small Business and Entrepreneurship Council found that from 2007 through 2009 "the Golden State was anything but golden, ranking among the worst states in eight [employment] categories. And given the size of the state and how badly its economy performed, California ranked dead last in changes in employment, total establishments, establishments with fewer than 100 workers, establishments between 100 and 499 employees, and establishments with 500 or more workers."**[7]**

But the recession only exacerbated what has been a longer-term trend in California employment. Since January 2001, employment has been on a consistent and persistent downward trend. In fact, there are over one-half million fewer jobs now than there were at the start of the new millennium, even as California's population has continued to rise over the last decade.

The decline in manufacturing has been even worse. There are over 36 percent, or 700,000, fewer high-wage manufacturing jobs in California now than there were in 2001, double the rate of decline for the United States as a whole. California has been hemorrhaging manufacturing jobs, while

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[5] *Id.*, p. 13.

[6] *Id.*, p. 14.

[7] Small Business and Entrepreneurship Council, *Surviving the Recession, Business Establishments and Jobs State by State*, October 2011, p. 14.

other states (and countries) have benefitted as a result of California's struggles. As the Milken Institute has recently pointed out:

> Our research shows that manufacturing—both traditional and high-tech—still drives California's economy in many ways, but the state is losing ground to other states and nations because of its regulatory climate, tax burden, and reputation as a difficult and costly place to do business.
>
> California has been progressively losing more of its manufacturing employment, particularly high-value-added manufacturing to other states such as Oregon, Texas, Minnesota, and Washington. To analyze California's comparative manufacturing competitiveness, case studies using data from 2000 through 2007 were conducted on California and seven other "peer manufacturing" states. Together, these seven states were home to 2.7 million manufacturing jobs compared with California's 1.5 million manufacturing jobs in 2007. The peer states added more than 62,000 manufacturing jobs since 2003, while California lost 79,000 manufacturing jobs during the same period.**[8]**

Job loss from business relocation and expansion of California companies in other states is being driven by the costs associated with the state's regulatory climate and tax burden. Development Counsellors International's recent survey of 322 executives of major corporations with direct site selection responsibility and location consultants placed California as the state with the worst business climate in the country. DCI concluded from the executives' write-in responses that "California was cited for having *high taxes* by 40% of respondents, while 36% mentioned *too much regulation*, 23% said *high cost* and 17% said *anti-business climate*."**[9]**

California as well as the US as a whole has not recovered from the recession that began at the end of 2007 and still faces tremendous economic challenges. Job losses have far outpaced job creation, which means the competition among states to attract and retain businesses and jobs will remain intense. Over 1.1 million jobs have been lost in California since December 2007, when the recession first began.**[10]** In December 2011, California's unemployment rate was over 11 percent

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[8] Milken Institute, *Manufacturing 2.0, a More Prosperous California*, June 2009, pp. 6-7.

[9] Development Counsellors International, *Winning Strategies in Economic Development Marketing, a View From Corporate America*, September 2011, p. 24.

[10] *Determination of the Dec. 2007 Peak in Econ. Activity*, Nat'l Bureau of Econ. Research, December 11, 2008, available at: http://www.nber.org/dec2008.html.

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compared to a U.S. unemployment rate 8.5 percent overall. Indeed, California has the dubious distinction of having the second-highest unemployment in the country, second only to Nevada's 12.6 percent.**[11]**

The steep job losses of the worst recession in decades appear to have ended in September 2009, and non-farm employment has been expanding slowly since. Unemployment has begun to trend downward from its record heights in recent months. California gained 116,000 non-farm jobs over the first seven months of 2011, an average gain of 16,600 jobs per month. While a positive development, it does not match much less reverse the average losses of 64,900 and 44,700 jobs per month in 2009 and 2008, respectively. Thus, even though California's employment situation has improved in recent months, unemployment remains high as the economy has recovered only a fraction of the jobs that were lost during the recession.**[12]**

2. The High Cost of Doing Business in California Is Having a Negative Impact on the State's Ability to Attract and Keep High-Paying Manufacturing Jobs

The evidence shows that California is losing the battle for new business investment. A recent survey of 400 companies conducted by the California Manufacturers and Technology Association (CMTA) revealed that 84 percent said they would not consider locating a new business in California if they were not already in the state and 72 percent said they did not have formal plans to grow in the state by more than 10 percent in the next five years.**[13]** The state is dead last in new manufacturing investment. From 2007 through 2010, according to CMTA, 10,763 industrial facilities were built or expanded across the country—but only 176 of those were in California. With 11.7 percent of the nation's manufacturing workforce,

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[11] U.S. Dept. of Labor, Bureau of Labor Statistics, Regional and State Employment and Unemployment Summary, January 24, 2012, available at: http://www.bls.gov/news.release/laus.nr0.htm.

[12] California Employment Development Department, *A Labor Day Briefing for California*, September 2011, p. 1.

[13] California Manufacturers and Technology Association, *California Regulatory and Competitiveness Survey Shows We Need to Get Smarter*, press release, April 8, 2011.

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California managed to attract only 1.6 percent of the new or expanded facilities.

California's perceived disadvantages as a business location have predictably led to ongoing active recruitment of California businesses by other lower-cost western and Midwestern states. Recently the Governor of Colorado visited California looking to strengthen ties with California businesses that have existing operations in Colorado and encourage them to look to Colorado when expanding.**[14]** Oregon has two initiatives aimed at luring California businesses north.**[15][16]** The city of Austin, Texas hired a California-based consultant to recruit California companies.**[17]** The Greater Phoenix Economic Council touted that 30 percent of the companies it has attracted have come from California.**[18]** Even the Governor of Iowa has been on the prowl in Silicon Valley.**[19]**

3. Energy Costs Are a Key Factor in Where Some Businesses Decide to Locate

Recent surveys indicated that energy cost is a key factor that businesses consider when deciding to relocate. This is particularly true for mid- to large-scale manufacturing operations that serve regional or national markets, as these firms typically explore multi-state location options and weigh all available cost drivers for each location.

Area Development Magazine annually surveys corporate executives and site location consultants to identify and rank relevant site selection factors they take into account when making a facility location decision. In the 2010 survey among the corporate respondents, "Energy Availability and Costs" ranked as the ninth most-important factor (with an importance rating of

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[14] *Hickenlooper, Hancock Head to California*, Denver Business Journal, November 29, 2011.

[15] *Oregon Looks to Recruit California Companies*, Portland Business Journal, November 9, 2011.

[16] *Watch Out, California!* Portland Business Journal, December 13, 2009.

[17] *Chamber Bolsters its California Recruiting Efforts*, Austin American-Statesman, December 16, 2010.

[18] *GPEC Finishes Year Landing 31 Businesses, 7,000 Jobs*, Phoenix Business Journal, July 19, 2011.

[19] *Iowa Governor Pitches Silicon Prairie*, San Jose Business Journal, December 7, 2011.

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82.1 percent) out of 26 site selection factors. Among professional site location consultants it was rated much higher, in fifth place with a 91.5 percent importance rating. As the Chief Financial Officer of Rubicon Technology, a manufacturer of high-quality monocrystalline sapphire products, noted, "When selecting a site for a new facility, the price of energy as well as infrastructure costs are key components of our decision-making process. The ability to have access to low-cost energy, as well as the ability to be flexible and manage these costs, has never been more important to maintain our competitive advantage."**[20]**

As energy costs are an important site selection factor, PG&E is at a competitive disadvantage with utilities serving states with which California routinely competes for business facilities. Table 1-1 below shows the average price in August 2011 charged by PG&E and its major out-of-state competing utilities for the large-load industrial sector, PG&E being the most expensive.**[21]**

TABLE 1-1
PACIFIC GAS AND ELECTRIC COMPANY
AND COMPETING OUT-OF-STATE UTILITIES
AVERAGE REVENUE PER KWH – INDUSTRIAL SECTOR

Line No.	Utility	State	Average ¢ per kWh
1	PG&E	CA	13.6
2	Nevada Power	NV	11.0
3	Arizona Public Service	AZ	8.4
4	Sierra Pacific	NV	8.3
5	Portland GE	OR	6.4
6	City of San Antonio	TX	6.9
7	Public Service of New Mexico	NM	6.8
8	Avista	WA	6.1
9	Pacific Power	OR	6.1
10	City of Seattle	WA	5.8
11	Entergy	TX	6.1
12	Idaho Power	ID	5.3
13	Rocky Mountain Power	UT	5.2
14	City of Tacoma	WA	4.9

Source: US Energy Information Administration, Form EIA-826,

[20] *25th Annual Corporate Survey and 7th Annual Consultants Survey*, Area Development Magazine, Winter 2011.

[21] US Energy Information Administration, *Form EIA-826 Data Monthly Electric Utility Sales and Revenue Data*, August 2011.

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"Monthly Electric Utility Sales and Revenue Report with State Distribution," August 2011.

Unprecedented energy costs were recently added to the list of the "Top Ten Reasons Why California Companies are Calling the Moving Van" by Joseph Vranich, The Business Relocation Coach, as companies try to meet competition based in other states and in foreign nations.**[22]**

Given all of the foregoing, it is no surprise that the push of higher costs plus the pull of active recruitment has resulted in increasing relocation of California businesses to other states. Vranich, whose business is to assist company site selection, documents 129 such "California disinvestment events," companies moving all or part of their operations to other states, during the first half of 2011. This rate, about 5.4 per week, has accelerated from 3.9 events per week in 2010 and 1 per week in 2009.

Companies leaving or expanding out of state range from Intel's new $3 billion manufacturing facility in Oregon to Sony's relocation of its Fresno distribution center operations to other U.S. distribution sites. Vranich lists the top five destinations for these companies as Texas, Arizona, Colorado, and Nevada and Utah (tied) and Virginia and North Carolina (tied).

4. The Unemployment Rate in Specific "High Unemployment" Areas Within California Is Among the Worst in the Country

A persistent high unemployment rate, while undesirable in and of itself, can also be an indicator of underlying structural weakness in a local economy. The counties that currently are registering unemployment rates in excess of 125 percent of the state average also have averaged similar high unemployment rates since 2000.**[23]** In addition, the high unemployment rates are forecast to persist through at least 2014 as population growth outpaces job creation.**[24]**

[22] Joseph Vranich, Why do Companies Leave California? Here Are Ten Reasons (Updated), Revised April 2011, available at: http://thebusinessrelocationcoach.blogspot.com.

[23] State of California Employment Development Dept., Labor Force Data Search Tool, *Annual Unemployment Rate by County 2000-2010.*

[24] University of the Pacific Eberhardt School of Business, *California and Metro Forecast*, January 2011, pp. 8-9.

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High unemployment can result in greater competition for existing jobs and lead to lower overall wages. As a result, counties with high unemployment are also characterized by lower personal income and higher poverty rates, as well as lower levels of educational attainment, than the state as a whole. Ultimately these workforce characteristics can conspire to limit interest of new businesses in locating, or of existing businesses expanding, in the area, giving these counties a disadvantage in competing for new business.

In the PG&E service area, counties with high unemployment tend to be concentrated in the Sacramento and San Joaquin valleys, from Shasta to Kern. Indeed, Dow Jones' MarketWatch 2011 Best Cities for Business survey which ranks the strength of the business environment in the top 102 metro areas over 500,000 population placed three Central Valley cities—Stockton, Fresno and Bakersfield—in the bottom ten *nationwide*. For example, MarketWatch reports that Fresno "has no Fortune 500, S&P 500 nor Forbes private firms, and is the largest city in the U.S. without a Russell 2000 company. While Stockton currently has the worst jobless rate, Fresno is at the bottom of the barrel for long-term unemployment. It hit 18.6 percent in February 2010 and has averaged more than 12 percent over the last two decades."**[25]**

PG&E's veteran account representatives, who have worked closely with numerous types of businesses in the San Joaquin Valley, have seen substantial change in business makeup in these higher unemployment areas. With a large pool of potential employees, strategic location and affordable housing in a state that's one of the largest markets in the world, it seems that companies would be clamoring to locate in these areas. But the reality is that they also share California's unfavorable tax and regulatory environment when compared to other states. Businesses need additional motivation to locate and stay. This EDR would help provide that.

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[25] MarketWatch, December 13, 2011, http://www.marketwatch.com/story/california-florida-ohio-cities-in-bottom-10-2011-12-13.

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D. PG&E's EDR Proposal Should Be Approved Promptly to Help Alleviate the Dire Economic Situation in California

As discussed further in Chapter 2 of this testimony, PG&E proposes to incorporate the current Standard EDR Option of 12 percent off an eligible customer's otherwise applicable tariff rate (excluding taxes) for five years into PG&E's new EDR proposal. This Standard EDR Option will continue to be available only to customers or potential customers with credible out-of-state location options or who would otherwise cease operations.

But in order to address the particular needs of attracting and retaining companies and jobs in severely impacted areas of the service territory, PG&E proposes to create an Enhanced EDR Option in counties where the annual unemployment rate for the previous calendar year was at least 125 percent of the state annual average. The Enhanced EDR Option will provide a 5-year, 35 percent reduction of an eligible customer's otherwise applicable tariff (excluding taxes). Areas where the unemployment rates are at such an acute level are particularly challenged when it comes to attracting and/or retaining employers, particularly those that have lower-cost, out-of-state location alternatives and are the target for economic development rates such as the one proposed here. The Enhanced EDR Option will help these areas compensate for their disadvantages and make it somewhat easier for them to compete for business locations. In addition, PG&E's new EDR proposal will be easier for customers to understand and for the Company to administer than the current Schedule ED by eliminating the floor price provision and state certification requirements.

Pursuant to Decision 10-06-015, Schedule ED will close to new customers on December 31, 2012. As discussed above, the economic situation in California is dire and is not anticipated to improve significantly in the near future. Therefore, the Commission should take timely action to approve PG&E's EDR proposal before the expiration of Schedule ED or as soon as possible thereafter.

E. Conclusion

The tale of the California economy is actually a story of two economies—the coastal counties where high tech, tourism and trade are starting to rebound from the recession; and the more inland counties where the recovery is proceeding

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more slowly. While the coastal areas such as the San Francisco Bay Area generally have unemployment rates below the state level, many counties (primarily concentrated in the Sacramento and San Joaquin Valleys) are experiencing persistent unemployment rates much higher than the state average. According to a recent UCLA Anderson Forecast, inland California's economy is falling further behind the rest of the state and faces at least six more years before it fully recovers from the recession, dragging down overall state growth.**[26]**

PG&E is aware that there are parts of the state where economic problems persist. Indeed, both parts of the "two Californias" are within the PG&E service area. PG&E feels that action is needed to address the problems faced by both Californias. Therefore, the Standard EDR Option should be re-authorized and the Enhanced EDR Option approved, giving a competitive boost to the entire PG&E service area.

Given the challenges facing California's economy, the need for economic development is even greater today than it was when PG&E's current EDR was last extended. A new EDR can be a key component in the state's economic revival. PG&E's EDR proposal is tailored to meet local conditions, either on its own or as part of a total package of incentives, and can spur business investment and job creation across PG&E's service territory.

[26] "UCLA Forecast Sees Slow Recovery for Inland California," Sacramento Bee, September 30, 2011.