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Room 3102

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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION E-3017
January 28, 1987

RESOLUTION

PACIFIC GAS AND ELECTRIC COMPANY'S (PG&E) REQUEST TO IMPLEMENT THREE AGREEMENTS WITH THREE MEMBERS OF THE HOSPITAL CONSORTIUM OF SAN MATEO COUNTY AND ONE AGREEMENT WITH LOUISIANA-PACIFIC CORPORATION ALL ENTITLED "AGREEMENT FOR ELECTRIC SERVICE". THESE AGREEMENTS PROVIDE FOR PERMANENT ELECTRIC SERVICE TO THE THREE HOSPITALS AND TO THE LOUISIANA-PACIFIC CORPORATION FACILITY UNDER A NEGOTIATED RATE.

INTRODUCTION

By Advice Letter 1130-E filed November 18, 1986 and by Advice Letter No. 1131-E filed December 17, 1986, Pacific Gas and Electric Company (PG&E) requests authorization to implement three agreements with three members of the Hospital Consortium of San Mateo County and One Agreement with Louisiana-Pacific Corporation (LP) entitled "Agreement For Electric Service". These agreements provide for permanent electric service to the three hospitals and to LP facility under a negotiated rate. The facts are as follows:

RECOMMENDATION

This resolution approves Advice Letter 1130-E and directs the utility to apply for future requests for approval of such contracts through formal application.

SUMMARY

1. By Advice Letter 1130-E PG&E submitted agreements with three members of the Hospital Consortium of San Mateo County, Mills Hospital District (MHD) in San Mateo, California, Peninsula Hospital District (PHD) in Burlingame, California and Sequoia Hospital District (SHD) in Redwood City, California. The agreements entitled "Agreement For Electric Service" are dated November 17, 1986 provide for permanent electric service to each of the hospitals under separate negotiated rates.
2. 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.

3. The contracts are the result of negotiations between PG&E and the above mentioned parties to avoid what PG&E claims would be an uneconomic bypass that would result if the hospitals and LP were to proceed with the proposed cogeneration project. The negotiated rates were offered as an alternative after standard rate schedules failed to dissuade the hospitals and LP from pursuing the proposed projects. The hospitals and LP intend to proceed with the projects should the agreements not be approved.

POSITION OF PG&E

1. The contract rates are designed to make the hospitals financially indifferent between PG&E service and the cogeneration alternatives. Each hospital contract contains the following provisions:

- The effective date of the agreement is March 1, 1988. This approximates the date on which the hospital could have commenced operation of the proposed cogeneration facility. The hospital will be charged for electric service under the regularly applicable rate schedule until the effective date.
- The agreement will be for a period of 15 years. Either party may cancel with a minimum of four years notice.
- The hospital agrees not to install nor allow a third party to install a cogeneration unit during the contract term.
- The agreement covers the electric output which would have been supplied by the cogeneration project. Any energy supplied in addition to output based on the above capacity shall be at the applicable rate. The plant output capacity is 961 Kilowatts (kWh) and PHD and 714 kW for SHD.
- The contract rate is designed to track the costs that each hospital would have incurred had it built the cogeneration project. The costs are based on engineering studies performed by PG&E and the hospital. (Cost data was provided to the staff by PG&E).

- 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 actual conditions. The adjustment is based on:
 - the inflation rate, PG&E gas rates for a cogeneration system, and PG&E standby charges.
- The monthly charges as calculated by the rate are the sum of cogeneration fixed costs, plus kWh times the cogeneration variable costs based on the above factors.
- The contract rate under current conditions would be somewhat less than the average rate of 6.2 cents/kWh under Rate Schedule A-22, but will still allow a substantial contribution to margin.
- The rate has a ceiling of revenue which would have been collected under the otherwise applicable electric rate schedule.
- The rate has a floor equal to PG&E's Seasonal Average Incremental Energy Rate, published in the Cogeneration and Small Power Production Quarterly Report, multiplied by the average commodity charge of PG&E's Power Plant Gas Rate, plus a negotiated 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 rates with the hospitals were developed to prevent the uneconomic bypass of PG&E's electric system. The hospitals have indicated that the cogeneration projects will be built if the contract does not receive Commission approval. Based on current avoidable costs, service under the contracts will collect an annual contribution to margin of approximately \$500,000 per year. The contract rates benefit the hospitals by offering power for the same cost as the cogeneration projects while mitigating risk by including the ceiling.

3. PG&E ratepayers benefit from not having to pick up the share of fixed cost which the contribution to margin will pay for and which would be lost if the hospitals leave 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 the hospitals 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 provisions of the proposed contract with LP are essentially the same as with the hospitals, except that the effective date is to be September 1, 1987 and the initial term will be for five (5) years.

7. PG&E requests that each filing become effective on the 40th calendar day after the date the advice letter is filed.

POSITION OF PROTESTANTS

1. Timely protests to Advice Letter 1130-E were filed by Cogeneration Service Bureau, Brockway, Inc., and the Public Staff Division of the Commission.

2. 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. Approval of this advice letter would commit PG&E and possibly its ratepayers to pay liquidated damages should PG&E or the CPUC cancel or modify the Agreement within the first ten years.

b. CSB protests this advice letter as premature because the issue of such discounts is before the Commission in PG&E's general rate case. The filing also proposes contract terms which go beyond what has been requested in the rate case. 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 these agreements will be recovered.

c. PG&E has requested the approval of Schedule E-85 which yields reduced rates similar to these agreements. E-85 is before the Commission in A.86-04-012 and a decision will be issued before the end of this month (December 1986). Lower industrial rates reduce the need for E-85. These agreements propose to go well beyond E-85 in assuming risks for ratepayers. PG&E should wait for the Commission's direction on Schedule E-85 and follow it in these agreements.

3. CSB also protests the term length of the proposed agreements and the liability of PG&E for liquidated damages and summarizes as follows:

Advice Letter 1130-E, and similar agreements that certainly will follow, will seriously weaken the cogeneration market with its long-term benefits to ratepayers. Such action involves policy decisions by the Commission that should be examined in public hearing.

The Cogeneration Service Bureau encourages large electric customers to seek lower electric rates for themselves. Such efforts, however, must be within the limits adopted by the Commission after public hearing.

4. Brockway, Inc., (Brockway) protested on grounds similar to CSB, but also objected to the proposed confidentiality of the contracts and the negotiated rates. Brockway also stated that another major concern arising from negotiated rates is that they invite real or phantom investment in cogeneration projects. To obtain the special discounts offered to customers contemplating cogeneration, many companies may investigate cogeneration simply as a guise to seek lower retail electricity prices.

5. In summary Brockway concludes that by Advice Letter 1130-E, PG&E asks the Commission to set a dangerous precedent at odds with laws requiring public disclosure of utility rates and contrary to established principles of utility ratemaking. Brockway asks the Commission to seriously consider how it would be perceived as protecting the public from the utility ratemaking practices when

such practices are confidential and the product of private negotiation rather than public ratemaking proceedings. Brockway, therefore, urges the Commission to uphold established principles of public access to the ratemaking process by rejecting the negotiated rates proposed by PG&E in Advice Letter No. 1130-E.

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

The Commission should take care not to establish a precedent by approving these agreements. 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.

Staff is concerned with bypass. But a simple assertion of uneconomic bypass should not bludgeon the Commission into approving contracts which have not been shown to benefit ratepayers, and which may well be harmful to them. Some bypass may benefit future ratepayers. Also, if the Commission approves the contracts, serious questions of equity arise among customer classes. PG&E also failed to demonstrate that, under the contracts, it would recover its own cost of service, that it would maximize the hospitals' contributions to margin (i.e., that PG&E had negotiated the best possible deal for ratepayers), or that the contracts were otherwise beneficial to PG&E's ratepayers.

If the Commission approves this advice letter, there could be a flood of advice letter filings for approval of special negotiated rates. This is not the way to deal with bypass. It must be done in a more systematic way, primarily through low revenue requirement and attention to cost-based rate design concepts. Bypass must be addressed generically. If it is not, important ratemaking issues such as margin contribution, equity, and ratepayers' interests will be ignored as advice letters are rubber stamped for approval when the word "bypass" appears.

If the Commission does not review these questions generically, it should approve advice letters for negotiated electric rates only under extraordinary circumstances. Such advice letters should be approved only if (1) The utility has clearly demonstrated that uneconomic bypass will occur if the special contract rate is not approved, and (2) the utility has shown that ratepayers will be better off with the contract than without it, and (3) the utility has demonstrated that it has made the best possible deal in its negotiated contract.

The advice letter has fallen far short of such a showing here. PG&E's advice letter features generalization, and not the specific information needed for an informed judgment. If the Commission approves the advice letter, it will abdicate important regulatory control and decisions to the ministerial workings of advice letter filings. This would be unsound regulation."

7. Additionally, PSD points out:

"Two of the self-generation projects (Peninsula and Sequoia Hospitals) that PG&E seeks to replace with negotiated rates would benefit society through productive utilization of solid waste (through incineration for use of the heat content rather than regular disposal), as well as the potential future contribution to PG&E's generation resources. In the long run, economic self-generation may benefit ratepayers more than keeping the load on the system. PG&E and other electric utilities have excess electricity capacity now, but are forecasting the need for future capacity additions. As the excess capacity disappears, self-generation becomes beneficial to the utility."

8. PSD states that the advice letter has not discussed or analyzed these questions. It simply assumes full benefits by preventing self generation. That short-term view and assumption needs analysis, not blind acceptance, and for the reasons discussed above the PSD asks the Commission to reject Advice Letter 1130-E (and by reference Advice Letter 1131-E).

RESPONSE BY PG&E

1. On December 17, 1986, PG&E responded to the protests to Advice Letter 1130-E by CSB and Brockway, and on January 5, 1987 responded to the PSD protest. The responses are summarized as follows:

"The agreements filed in Advice 1130-E were negotiated for the specific reason that each of the hospitals were in the process of making commitments to cogeneration projects which would result in the loss of contribution to PG&E's fixed costs. Had PG&E not negotiated promptly, but waited for the resolution of the General Rate Case as suggested by the Cogeneration Service Bureau, all of the hospitals' contributions to PG&E's fixed costs (except any standby revenues would have ultimately been lost. That is, the restructured industrial rates proposed by PG&E and the PSD in the General Rate Case, if adopted as proposed, would very likely not be competitive with the projected cogeneration costs for the hospitals. By January, the hospitals would have made irreversible

commitments to on-site generation. As an alternative, PG&E negotiated a rate to keep the customer on the system and maintain a contribution to fixed costs for the long run. The approximate \$500,000 annual contribution to fixed costs will be shared among ratepayers if the Commission approves these contracts."

"The deviation from the contract form specified in our previous E-85 filing was necessary to obtain an agreement with the customers to prevent uneconomic bypass. The liquidated damages provisions was included because of the unique circumstances of these customers. If the customers enter into these agreements with PG&E, they will lose presently available grant money. PG&E does not intend to enter into similar provisions with other customers not having comparable circumstances. Further, the value of liquidated damages, if invoked, is minimal compared to the expected margin contribution over the life of the contract. By inclusion of a floor on the effective rate, PG&E is protected from selling energy at a cost below marginal cost plus a contribution to margin, thus making a 15-year contract term acceptable."

"The policy underlying the confidentiality of negotiated rate contracts is to prevent potential customers from gaining an unfair advantage in negotiating rates. Making information about existing negotiated rates available to potential customers only puts them in a position to attempt to negotiate for the lowest existing rate. Unnecessarily low rates would reduce the contribution to margin received from negotiated rates, thereby raising rates for the other ratepayers. Further, maintaining the confidentiality of customer-specified cost information contained in the attachments to the contracts is appropriate to protect any customer with whom PG&E negotiates from the release of proprietary business information."

According to the Cogeneration Service Bureau, the "cogeneration market" will provide "long-term benefits to ratepayers." While PG&E continues to support their party development, it makes no sense not to encourage the construction of facilities that produce electricity at costs higher than PG&E's marginal costs. In our current capacity rich environment, properly negotiated contract rates that prevent uneconomic bypass are to the benefit of all PG&E ratepayers. Failure to approve the contracts will send a message to the many large customers currently considering on-site generation to proceed with leaving the PG&E system. The resulting rate increases will be borne by the remaining ratepayers. Thus to keep rates lower for all ratepayers, and to avoid the uneconomic bypass of PG&E's system, the Commission is urged to approve Advice Letter 1130-E without delay."

DISCUSSION

These advice letters provide the Commission with its first look at the negotiated contract approach to the problem of electric bypass. 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 participation 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 individual 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 these contracts. 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 of \$780,000 per year beginning on March 1, 1988 if the hospitals leave the PG&E system and an estimated reduction of \$280,000 per year under the contract sales rate. PG&E has taken appropriate steps to mitigate the loss of margin. We anticipate that PG&E will bring other contracts, negotiated on substantially similar bases, before us for authorization. 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 Three R proceeding 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.

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

1. The subject contracts 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 March 1, 1988) 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. These three contracts, 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 March 1, 1988, 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 these three contracts 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.
7. PG&E shall inform the Commission by a supplemental advice letter whether it accepts these conditions and chooses to exercise the contracts.

We stress that despite our approval of these contracts, we will include the load that they represent 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 and effect 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.

Advice Letter 1131-E, by which PG&E requests authorization to perform under a contract for negotiated rates with Louisiana-Pacific Corporation, is subject to our review independent of the terms and conditions of this resolution.

FINDINGS

1. The advice letters request Commission approval of written agreements between PG&E and three hospitals and an industrial customers. The agreements propose electric service to each of the customers under separate negotiated rates.
2. The negotiated contract rates are lower than the hospitals 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, the hospitals now plan to self-generate electricity if they are forced to pay rates under the current schedule. The negotiated agreements, if approved, would keep the hospitals 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 contracts.
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. One of the self-generation projects by the hospitals would utilize solid wastes as fuel and thus could be beneficial to society and to ratepayers.
8. 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).
9. The contracts mitigate the potential loss of margin that would occur if the customers engaged in self-generation.
10. The contracts should be subject to reasonableness review.
11. The unconditional authorization of PG&E to carry out the terms of the contracts is adverse to ratepayer interests.

12. Sales made pursuant to the terms of the contracts should be excluded from consideration in any ERAM proceeding.

13. The difference in margin contributed from sales under the relevant E-20 schedule and sales made pursuant to the contract terms (commencing March 1, 1988) should be accounted for in a memorandum account and accrue interest at the ECAC rate.

14. The contracts 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.

15. If the electric utility ratemaking framework has not been revised by March 1, 1988, then the balance will remain in the memorandum account pending Commission action.

16. 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 case. 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 Letters 1130-E is approved, subject to conditions 1 through 7 listed in the text of this resolution.

2. Pacific Gas and Electric Company and any other electric utility seeking approval of contracts that were negotiated with the intent to avoid customer bypass 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.

3. The effective date of this Resolution is January 28, 1987.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on January 28, 1987. The following Commissioners approved it:

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



Executive Director