

June 22, 2000

ADVICE 2011-E

Public Utilities Commission of the State of California

REDACTED VERSION

Pursuant to the Restructuring Advice Letter Filing (“RALF”) procedure the Commission adopted in Decision 98-12-066, Pacific Gas and Electric Company (the Company) submits for Commission approval: 1) the Amended and Restated First Amendment (ARFA) (Attachment C) to the Power Purchase Agreement (PPA) (Attachment A), as amended by the First Amendment (First Amendment) (Attachment B), between Sierra Pacific Industries (SPI) and the Company; and 2) a modified Enabling Agreement (EA) (Attachment D) similar to that which the Commission approved in Resolution E-3625 (the ARFA and EA are collectively referred to as the Agreements). The ARFA and EA will become effective only after receipt of Commission approval acceptable to the Company. If the Commission approves the Agreements as proposed herein, the Company estimates that ratepayers may expect to receive **[REDACTED]** in net benefits.

PURPOSE

The Company seeks a Commission resolution approving as reasonable the attached ARFA and EA. The Agreements and supporting data were submitted to the Office of Ratepayer Advocates (ORA). After its review, ORA issued a letter (Attachment E), which states ORA’s support for obtaining Commission approval of the ARFA and EA.

Accordingly, the Company asks that the Commission adopt a resolution that:

1. Approves both the ARFA and EA as reasonable.
2. Authorizes recovery of all payments that the Company has made and will make pursuant to the Agreements through the Company’s Transition Cost Balancing Account or any other cost recovery mechanism subsequently authorized by the Commission, subject only to the Company’s prudent administration of the Agreements.
3. Authorizes the recovery of **[REDACTED]** as the shareholder incentive associated with this negotiation.

BACKGROUND

Sierra Pacific Industries PPA (Pacific Gas and Electric Company Log No. 10C018)

In December 1984, SPI and the Company entered into the 30-year PPA for a proposed 12,500 kW wood waste-fueled cogeneration project (the Project). Under the PPA, the Company agreed to purchase energy and capacity from the Project.

SPI began deliveries from the Project on December 19, 1986¹. On March 5, 1987, SPI successfully concluded its firm capacity demonstration test for 12,500 kW of firm capacity under the PPA. The term of the PPA extends to March 4, 2017.

Firm capacity payments are based on 12,500 kW for 30 years at a price of **[REDACTED]**. Firm capacity payments are subject to minimum performance requirements and obligations defined in the PPA. SPI is also eligible for firm capacity bonus payments of up to 17.6 percent if its generation meets specified performance requirements; immediately prior to the effective date of this filing, SPI was receiving firm capacity bonus payments of **[REDACTED]**.

Under the PPA, the Company also pays SPI for capacity delivered in excess of firm capacity on an as-delivered capacity basis in accordance with as-delivered capacity payment option 1 at the current as-delivered capacity prices authorized from time to time by the Commission. The as-delivered capacity price is currently \$60.23/kw-year.

In May 1991, SPI and the Company executed the First Amendment.² The First Amendment, among other things, changed the description of the Project in Article 3(b) of the PPA from 12,500 kW to 16,000 kW, modified the energy pricing provisions of Article 4 of the PPA, and added the definition of a “non-firm

¹ SPI first began to make deliveries to PG&E from the site of the Project on January 14, 1983, pursuant to a predecessor agreement to the PPA.

² The First Amendment was approved by Decision 96-05-032.

interruptible energy price.” The non-firm interruptible energy price was based on the price the Company paid for marginal non-firm energy purchases from other utilities and governmental power authorities.

The First Amendment was executed at a time when the Parties were subject to an “interim solution” that the Commission adopted in Decision 84-08-037 to address transmission constraints in the northern portion of the Company’s transmission system, where the Project is located. Under the interim solution, as it evolved, the Company maintained a list of projects that had been allocated access to transmission capacity in the Company’s northern area, and a “waiting list” of projects that had yet to receive transmission allocations. The Project was on the latter list.

Since the Parties executed the First Amendment, major structural changes have occurred in the California electric energy market that affect the First Amendment. The waiting list for transmission capacity in the Company’s northern transmission system³ was discontinued, and the Company and other investor-owned electric utilities now have a mandatory buy-sell requirement that requires the utilities to bid all of their generation into the California Power Exchange (PX) and satisfy their need for electric energy with purchases made from the PX.⁴ This precludes the Company from making marginal economy energy purchases from other utilities or governmental power agencies.

More recently, in May 1999, the Company submitted to the Commission Advice 1870-E⁵ in which the Company sought authorization to offer two new standard form agreements related to power purchase agreements the Company has with Qualifying Facilities (QFs), namely an “Enabling Agreement for ‘Surplus Sale’ QF Suppliers” and a “Pro-Forma PPA Amendment and Enabling Agreement for ‘Net Sale’ Interim Standard Offer 4 PPAs.”

These standard form agreements are intended to create opportunities for expanding the markets for energy and ancillary services in California. The agreements specify the terms and conditions pursuant to which QFs who have

³ Decision 92-10-015; 45 CPUC 2d 673.

⁴ Decision 95-12-063; 64 CPUC 2d 1 as modified by Decision 96-01-009; 64 CPUC 2d 228.

⁵ Resolution E-3625, dated August 5, 1999, approved Advice 1870-E.

standard offer PPAs with the Company may sell excess energy and ancillary services to third parties, including direct access customers, the Independent System Operator (ISO), and the PX. Such sales, including sales pursuant to the proposed EA with SPI, could make the market more efficient, by putting downward price pressure on the ancillary services markets and thereby potentially dampen price spikes similar to those experienced in these markets in the past, thus saving ratepayers money. The agreements also provide QFs with opportunities to become familiar with the evolving energy and ancillary services markets.

Among the eligibility criteria for these new standard form agreements is the requirement that the scheduling, curtailment, and dispatch provisions of a QF's standard offer PPA be unamended. The First Amendment altered the curtailment provisions of SPI's PPA, thereby making SPI ineligible to sign a standard form Enabling Agreement. SPI does, however, desire to sell a portion of its power to third parties and made this request to the Company. Additionally, SPI expanded the Project's generation capability in 1999 and asked to amend the PPA to reflect the Project's available generation capacity as the Project is currently configured.

To accommodate SPI's requests and to restate the First Amendment so as to make the contract language congruent with the current status of the California energy market and the expanded generation capabilities of the project, SPI and the Company negotiated the Agreements that are the subject of this RALF, and are described below.

The Project

The Project consists of two wood waste-fueled, single cycle, small power production facilities at SPI's industrial plant site located at 1538 Lee Road in the city of Quincy, Plumas County. The generator installed under the PPA is hydrogen cooled and has a rating of 25,000 kVa with a 0.80 power factor, or 20,000 kW. It is a non-reheat and condensing steam turbine/generator set manufactured by General Electric (GE) in 1952 and reconditioned in 1986. The steam turbine has three controlled extraction stages for feedwater heating, plant use and export to kilns. The boiler is a single drum, fixed grate stoker supplied new by Riley Stoker in 1986.

The second turbine and generator set is rated at 10,714 kVa at 0.70 power factor or 7,500 kW. The second steam turbine/generator set was installed in April 1999. Although GE originally manufactured the generator in 1936, the

steam turbine has been reconfigured to be non-condensing, so the steam exhausts at a lower pressure for lumber drying in kilns. Because of this reconfiguration in the steam turbine, generator output is limited to about 5,000 kW. Presently this 5,000 kW of electric energy is used to serve on-site industrial load. A second, single drum traveling grate boiler was supplied by Zurn and installed in November of 1998.

OWNERSHIP OF THE SPI FACILITY

SPI Quincy is owned by Sierra Pacific Industries, a California corporation. PG&E Corporation and its affiliates are not affiliated in any way with Sierra Pacific Industries.

HISTORICAL OPERATIONS AND COMPLIANCE WITH PERFORMANCE AND EFFICIENCY STANDARDS

The Project's Historical Performance

Generation from the project ranged from [REDACTED] per year during the fixed price period, which terminated on December 18, 1996. Since December 1996, and through April 1999, the generation level has averaged about [REDACTED]. Following the addition of the second generator in April 1999, generation from the Project increased to approximately [REDACTED]. The project's detailed generation history is included in the analysis in Attachment F.

Historic Performance Bonus Factors

The Project's historic firm capacity bonus factors for the last five years are shown below.

<u>Effective Date</u>	<u>Firm Capacity Performance</u> <u>Bonus Factor</u>
9/1/1995	[REDACTED]
9/1/1996	[REDACTED]
9/1/1997	[REDACTED]
9/1/1998	[REDACTED]
9/1/1999	[REDACTED]

Compliance with Performance and Efficiency Standards

The Project is a small power production facility as defined in the Federal Energy Regulatory Commission's (FERC) regulations. (18 C.F.R., Part 292, Subpart B.) The percentage of gas or oil the Project has used in its operation has historically been zero based on the information available to the Company. Therefore, the Project meets the FERC's fuel use criteria specified in 18 C.F.R. § 292.204(b).

SUMMARY OF THE AGREEMENTS

This restructuring consists of both the ARFA and EA, which are both conditioned on receipt of Commission approval acceptable to the Company. The Agreements are described separately below.

The ARFA

The ARFA modifies the PPA as amended in the following principal ways:

- Changes the description of the Project to from 16,000 kW to 35,700 kVa to reflect the actual generating capacity of the installed equipment. (ARFA, ¶ 2.)
- Clarifies that the Company's obligation to purchase energy from the Project is limited to 16,000 kW (or [REDACTED] during certain hours of economic curtailment). (ARFA, ¶ 5.)
- Clarifies that the Company's obligation to pay for as-delivered capacity above the 12,500 kW firm capacity amount is limited to 3,500 kW. (ARFA, ¶ 6.)
- Eliminates the Company's obligation to pay for energy deliveries above [REDACTED] during [REDACTED] super off peak hours of each calendar year, formally paid at "non-firm" rates. (ARFA, ¶ 8.)

- Adds a waiver and release of all claims arising out of the First Amendment. (ARFA, ¶ 12.)
- Adds dispute resolution provisions. (ARFA ¶ 13.)
- Adds standard contract interpretation provisions. (ARFA, ¶ 14.)

In addition, the ARFA carries forward other provisions of the First Amendment (ARFA, ¶ 1, 3, 4, 9, 10)without change, and deletes the definition of “non-firm interruptible energy price” (First Amendment, ¶ 8) because that definition is no longer relevant (the Company presently cannot buy non-firm energy from the Pacific Northwest).

The EA

The EA is a modified version of the “Enabling Agreement for ‘Surplus Sale’ QF Suppliers.” The standard form EA was altered to reflect both the non-standard curtailment language contained in the First Amendment and to recognize that the Company’s obligation to purchase energy from the Project is limited to 16,000 kW. The principal difference between the SPI EA and the standard form EA is the elimination of the Company’s obligation to purchase any “excess energy” from SPI as defined in the EA. (The standard form EA gives the Seller the option to sell “excess energy” either to third parties or to the Company during a period ending June 30, 2000.) Other non-standard language was added which prohibits sales of excess energy during hours when the Company is exercising its non-standard curtailment rights. (EA, ¶ 5.1.3.)

Like the standard form EA, the SPI EA will terminate by its own terms on June 30, 2001, unless the Parties agree to extend its term. If the EA terminates, the ARFA gives SPI the right to sell excess energy to the Company up to 21,000 kW at prices equal to **[REDACTED]** of the Company’s short-run avoided costs while the parties attempt to negotiate a successor agreement. (ARFA, ¶ 5.)

RATEPAYER BENEFITS AND SHAREHOLDER INCENTIVE

Under the existing PPA, for the remaining years until the agreement terminates on March 4, 2017, the Company is to pay SPI over-market prices for Quincy’s “regulatory must-take” power.

The reduction in as-delivered capacity payments, incremental energy deliveries price discount and the elimination of certain potential disputes that could arise (given the changed circumstances in the California energy market that have occurred since 1999) represent a tangible ratepayer savings of **[REDACTED]**.

See Attachment F which details the calculations and the associated explanatory notes. Additional savings could result from the avoidance of transaction costs associated with litigation. These benefits were the basis of the shareholder incentive the Company requested associated with the Agreements as part of this RALF.

The NPV dollars mentioned above are based on January 1, 2000 values. The Company used an annual discount rate of 8.75 percent, which is the Company's weighted average cost of capital for 1999.⁶

ORA reviewed the Agreements and met with the Company to discuss a variety of topics associated with this restructuring, including the amount of ratepayer incentive the Company should recognize as a result of negotiating and gaining approval of the Agreements. Although the Company believes that the amount of shareholder incentive should be [REDACTED], the Company agreed to a negotiated reduction to [REDACTED]. The circumstances regarding the Company's decision to accept the lower amount are unique and confidential, and the Company's consent to a reduced shareholder incentive payment for these Agreements is in no way precedential or binding on the Company for future, similar agreements. ORA, as stated in its June 9, 2000 letter, supports Commission approval of the Agreements, subject to a reduction in shareholder incentive to [REDACTED]. (See Attachments E and F for more details.)

LEGAL OR REGULATORY DISPUTES

The release and waiver provision of the ARFA (§ 12) is intended to apply to a potential dispute between SPI and the Company arising from the First Amendment, and the modifications the ARFA makes are intended to reduce the risk of similar disputes in the future. The potential dispute is related to the changed circumstances in the California electric energy market described above. For example, during the fixed price period, the First Amendment provided that the Company would pay SPI for energy deliveries exceeding 16,000 kW at "non-firm energy prices," as defined in the First Amendment. (First Amendment, § 5) The definition of "non-firm energy prices" in the First Amendment includes the following language:

⁶ See, Decision 99-06-057, Findings of Fact No. 21; Ordering Paragraphs 1 and 2.

A price, offered by PG&E on a monthly basis, based on the price that PG&E will pay for purchases of Non-firm Energy for (sic: from) other utilities and governmental power authorities during the following month...

The Company, however, no longer makes such non-firm energy purchases. Thus the First Amendment is arguably ambiguous as to whether the Company has any obligation to purchase energy deliveries above 16,000 kW. If the Company does have such an obligation, it is unclear what the appropriate price should be.

Similarly, the Company's obligation to pay for as delivered capacity for deliveries above 16,000 kW is contingent on SPI's receipt of "a transmission allocation." (First Amendment, ¶ 6) As noted above, Decision 92-10-015 eliminated the concept of a transmission capacity allocation.

By approving the ARFA and the EA proposal in this RALF, the Commission will help the Company and SPI reduce substantially the potential for similar issues in the future.

SPI'S PROJECTED ECONOMIC AND OPERATIONAL VIABILITY

The Company did not prepare an economic analysis of SPI's future viability, due to the nature of this restructuring agreement. Projected ratepayer benefits resulting from the ARFA occur during 1999 and 2000. Viability is therefore not at issue here. If the project becomes uneconomic in the future and stops operating, the Company ratepayers will not be disadvantaged due to the ARFA. Also, after inspecting the Project, the Company concluded that the Project is well designed, built, operated and maintained. The Company believes that if SPI maintains its current level of maintenance on the Project in the future, the Project will be viable throughout the remaining term of the PPA.

PG&E requests that this filing become effective on **August 1, 2000**, which is 40 days after the date of filing.

This filing will not increase any rate or charge, cause withdrawal of service, or conflict with any rate schedule or rule.

Anyone wishing to protest or respond to this advice filing may do so by submitting such protest or response no later than 20 days after the date that

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notice of this filing is given the Commission's Daily Calendar. The protest or response should be transmitted to:

IMC Branch Chief
Energy Division
California Public Utilities Commission
505 Van Ness Avenue, Room 4002
San Francisco, California 94102
Facsimile: (415) 703-2200

Copies should also be mailed to the attention of the Director, Energy Division (address above), and Les Guliasi, Regulatory Relations Manager, 77 Beale Street, Mail Code B10C, P.O. Box 770000, San Francisco, California 94177, Facsimile (415) 973-7451. The protest should set forth the grounds upon which it is based and shall be submitted expeditiously. There are no restrictions on who may file a protest or response.

In accordance with Section III, Paragraph G of General Order 96-A, the Company is mailing copies of this advice filing to the utilities and interested parties shown on the attached list. Address change requests should be directed to Nelia Avendano at (415) 973-3529.

Vice President - Regulatory Relations

Attachments

INDEX OF ATTACHMENTS [REDACTED]

- A. Power Purchase Agreement and other Associated Agreements
- B. First Amendment to the Power Purchase Agreement
- C. Amended and Restated First Amendment to the Power Purchase Agreement
- D. Enabling Agreement
- E. ORA Letter of Support
- F. Detailed Analysis Spreadsheet