EXECUTIVE SUMMARY: ECONOMIC DEVELOPMENT RATES

(Witnesses - Robert Levin and Elise Torres)

I. INTRODUCTION AND SUMMARY

DRA supports the goals of enhancing California's competitiveness and increasing the number and quality of jobs available to California residents. PG&E has proposed new Economic Development Rates ("EDR") intended to achieve these goals. DRA finds that PG&E has correctly identified a need for a new EDR program, with changes from the current EDR, to meet the goals stated above. Unfortunately, DRA cannot support PG&E's EDR proposals, without major modifications, because they create unacceptable risks for ratepayers. PG&E has proposed numerous and major departures from the ratepayer protections incorporated in the current, expiring EDR framework. PG&E's proposals, if adopted, could harm, rather than benefit, ratepayers. However DRA offers its own version of PG&E's proposed Standard and Enhanced EDR Options, intended to help eligible "at risk" businesses maintain and expand job opportunities in California while providing reasonable assurance of ratepayer benefits.

If carefully crafted and appropriately applied, an EDR program can benefit ratepayers while providing a tool, among other tools, to support a stronger business climate in California. An EDR, however, involves risks, as well as rewards, for ratepayers. Indeed, compliance with P.U. Code Section 740.4 (h) makes it incumbent upon the Commission to include appropriate ratepayer safeguards intended to ensure that the benefits of EDR outweigh the risks.[1] Accordingly, the Commission must bear in mind that California's electric rates are already among the highest in the Nation. Without proper safeguards, an EDR program can increase rates to nonparticipating ratepayers, and potentially do more harm than good. A quote from D.05-09-018 is equally applicable today:

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[1] P.U. Code Section 740 (h) requires that "the ratepayers of the public utility derive a benefit" from an economic development rate.

"The adoption of this EDR should also be viewed as a stopgap measure to address a small part of the harmful impacts the current rate levels have on California's economy and the state's potential for economic growth and development. ......However, the need for this EDR serves as a flashing warning light that we must continue to take all steps necessary to address the level of rates in California."

In its current application, PG&E requests authority "to establish an Economic Development Rate (EDR) that is specifically tailored to address varying economic conditions in the Company's service area." In addition to retaining the "Standard" 5-year, 12% discount EDR option, PG&E proposes to create a new "Enhanced" EDR option in counties where the annual unemployment rate for the previous calendar year was at least 125% of the state annual average. The Enhanced EDR Option would provide a 5-year, 35% reduction of an eligible customer's otherwise applicable tariff[2].

PG&E's EDR proposals are summarized and compared with the current EDR program in Table ES-1. Tables ES-2 and ES-3 present a similar comparison (DRA's EDR proposals vs. the current EDR).

The issue of adequate ratepayer safeguards is a key concern raised by PG&E's new EDR proposals, which would jettison many of the ratepayer safeguards built into the current EDR program. Chief among current safeguards is a floor price, which consists of the sum of marginal costs and nonbypassable charges ("NBCs"). The floor price serves to ensure that nonbypassable rate components are not discounted and that the marginal costs of serving participating customers' demands are not shifted to other customers. PG&E now proposes to eliminate the floor prices, along with other safeguards such as third-party oversight of customer eligibility for EDR, vital features of the customer affidavits, and critical elements of the EDR contracts.

[2] In both EDR options, the discounts would apply to the applicable tariff rate excluding taxes.

Table ES-1: Current EDR vs. PG&E's Proposals

Current EDR	**PG&E Proposal**
Standard 12% Discount, 5-year term	Standard 12% Discount, 5-year term
No enhanced discount option	Enhanced 35% discount in high unemployment counties, 5-year term
Additive floor price based on Marginal cost + NBC Rate Components, enforced annually, ex ante & ex post	No floor price
CTM cannot be negative in any year	CTM can be negative over contract term
Annual ex post back billing to recover negative CTM from EDR customer	No ex post recovery from EDR customer
Distribution constrained by marginal cost floor	Negative distribution rates allowed
Generation constrained by marginal cost floor	Generation not discounted
No discounting of NBC Rate Components (including Transmission)	NBC rate components are effectively discounted in some cases, via negative distribution charges
No PG&E shareholder participation	No PG&E shareholder participation
200 MW cap	No cap
• Approval of applicants by CalBIS required; • limit participation to customers whose energy costs are at least 5% of operating costs, • implement with an affidavit provision; • requires PG&E to conduct energy audit of the applicant's facility & discuss cost effective EE/ demand side management measures with applicant.	• No third party oversight required. • implement with an affidavit provision without the provision verifying that energy costs are at least 5% of operating costs; • requires PG&E to conduct energy audit of the applicant's facility & discuss cost effective EE/ demand side management measures with applicant.
Assignment of Contracts permissible only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all respects	Assignment of Contracts permissible only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all respects
EDR contracts can be renewed for one additional 5-year term.	Standard and enhanced EDR contracts can be renewed for one additional 5-year term.
Liquidated damages clause for customer fraud or misrepresentation	Liquidated damages clause for customer fraud or misrepresentation

PG&E's rationale for the elimination of floor prices notes that the resulting "significantly smaller available discount made it difficult or impossible to offer a customer a sufficiently meaningful incentive to sway the location decision." DRA agrees that application of the current floor price did not enable PG&E to provide the full 12% discount otherwise allowed by the EDR program. However, DRA strongly disagrees with PG&E's proposed remedy, which is the complete elimination of a price floor for EDR contracts. DRA believes that a price floor is a necessary ratepayer safeguard, and discusses proposals for modifying the existing price floor to allow for meaningful discounts when warranted, while still protecting ratepayers from cost shifting.

Existing ratepayers benefit from PG&E's acquisition of new customers, or retention of existing "at risk" customers, as long as the revenue provided exceeds the incremental cost (or marginal cost) of service. Therefore, "ratepayer benefit" is measured by the excess of the revenue provided by the new or retained customer above the marginal cost. This quantity is often termed "contribution to margin," or CTM. Thus, a marginal cost-based floor price is needed to ensure a positive CTM, and thereby provide ratepayer benefit.

Lacking a price floor, PG&E's EDR proposals would result, in some instances, in a negative CTM over the proposed 5-year contract term[3]. DRA believes that such an outcome would violate the provisions of P.U. Code 740.4(h). While PG&E cites the benefits of job retention and job creation, DRA questions whether those benefits would fall in the purview of "ratepayer benefits" as that term is used in P.U. Code 740.4(h), and thus, whether such benefits can offset a negative CTM.

DRA also takes issue with PG&E's proposal to design its Enhanced EDR Option as a 35% discount in each year of the 5-year contract term. Not only would a 5-year 35% discount would violate DRA's modified floor price proposal; it would result in a

[3] PG&E's testimony asserts that, in all cases, the net present value of CTM would be positive in 10 years, under the assumption that the customer pays the full tariff rate after contract year 5. This is a rather strong assumption: there is nothing that would prevent a customer from leaving the State after 5 years, or seeking a second 5-year EDR contract; either action could result in a negative 10-year CTM if the initial

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nearly 50% rate increase if the customer returns to full tariff after the 5-year EDR contract term. To mitigate these effects, DRA proposes a declining discount for eligible customers in high-unemployment counties, beginning with a 35% discount in contract year 1 and declining to 30%, 20%, 15%, and 10% in contract years 2-5, respectively. DRA's proposal is roughly equivalent to a 22% discount over 5 years, and, in most instances, would be allowed by DRA's proposed modified floor prices.

In summary, DRA believes that a carefully crafted EDR program can be beneficial and supports a modified version of PG&E's EDR proposals. DRA's proposal includes a declining Enhanced EDR discount, a modified floor price, continued third-party oversight, and appropriate participation by PG&E shareholders. DRA's recommendations are summarized in the next section.

II. SUMMARY OF DRA RECOMMENDATIONS

DRA recommends the following:

1. A Standard Option EDR program with a 12% discount over a 5-year contract term should be available everywhere in PG&E's service territory, to bundled service, direct access ("DA"), and Community Choice Aggregation ("CCA") customers, subject to pricing floors which may limit the available discount in a few cases.

2. An Enhanced Option EDR program offering a declining discount starting at 35% should be available in counties with unemployment rates of more than 125% of the statewide average. The discount would decline to 30% in year 2, then to 20%, 15%, and 10% in years 3, 4, and 5, respectively. Available discounts to DA and CCA customers may be limited by price floors.

3. All EDR contracts should be required to demonstrate a positive contribution to margin ("CTM") over the 5-year contract term on an ex ante (forecast) basis.[4] The following should be included in the marginal cost used to calculate the CTM: (a)

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5-year CTM is negative.

[4] That is, the 5-year net present value of the contract revenue must exceed the 5-year net present value of the marginal cost to serve the customer.

marginal generation costs[5], including a 15% resource adequacy adder in the marginal generation capacity cost; (b) marginal distribution cost for constrained or unconstrained areas, as applicable; (c) the full retail transmission rate; and (d) the DWR bond charge.

4. In addition, as a separate test from #3 above, EDR contracts may not discount nonbypassable ("NBC") rate components[6].

5. As a third test, EDR discounts should be subject to a modified additive price floor applied over the 5-year contract term, but not necessarily annually. The modified additive price floor should consist of the NBC rate components, plus the marginal energy cost and the marginal distribution cost. Thus it excludes marginal generation capacity costs, which are captured separately in #3 above. The 5-year net present value of the contract revenue should exceed the 5-year net present value of the modified additive price floor.

6. Distribution rates should be discounted subject to a distribution marginal cost floor. Negative distribution rates should not be allowed.

7. Generation rates may be discounted as needed to achieve the nominal discounts recommended above, subject to the recommended 5-year marginal cost and modified additive price floors.

8. The Commission should find that PG&E's proposed 35% Enhanced Option EDR discount could result in a negative CTM over the 5-year contract term and should be rejected on that basis.

9. The Commission should adopt DRA's recommended discounted rates for Standard Option and Enhanced Option EDR customers as shown in Appendix I. CTM calculations for PG&E's and DRA's proposals are summarized in Appendix G.

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[5] DRA recommends that the 2011 GRC Phase 2 settlement marginal energy cost value be averaged with PG&E's indexed value over the 5-year contract, with a 20% weighting of the Settlement value and 80% weighting of the indexed value. DRA also recommends that this weighted average value be used to evaluate the 10-year CTMs.

[6] The following rate components may not be discounted: The retail Transmission rate components; Public Purpose Programs; Nuclear Decommissioning charges; Competition Transition Charges; New System Generation Charges; DWR Bond Charges, and Power Charge Indifference Adjustment (for DA and CCA customers).

10. The Commission should discontinue its current practice of adjusting EDR customers' bills "after the fact" to reflect unforeseen changes in marginal costs that occurred after the contract was finalized.

11. The Commission should impose a cap of 200 MW on EDR program participation.

12. PG&E's shareholders should bear 25% of the revenue shortfall due to EDR discounts, provided the Commission adopts floor prices substantially as proposed by DRA.

13. PG&E's shareholders should bear 50% of the revenue shortfall due to EDR discounts, if the Commission adopts EDR discounts without a floor price as proposed by PG&E.

14. PG&E's shareholders should bear 100% of any negative cumulative CTM resulting from PG&E's EDR portfolio after 10 years from the inception of the first post-2012 EDR contract.[7]

15. PG&E should track annual CTM by EDR contract and for the total EDR program, in a balancing account or memorandum account created for that purpose[8]. If cumulative EDR portfolio CTM becomes negative, after 5 years (i.e., in 2018) due to unforeseen changes in the marginal costs, then the amount of negative CTM should be credited to ratepayers. Should portfolio CTM turn positive in years 6 through 10, any such credits should be reversed, so that shareholder would made whole as long as the EDR portfolio has produced a positive CTM by the end of year 10 (i.e., 2022).

16. EDR customers should be required to sign a customer affidavit that includes a provision that electricity costs constitute at least 5% of the customer's operating expenses. The California Business Investment Services ("CalBIS") should review customer applications and approve them before customers are permitted to participate in the EDR program.

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[7] See Chapter 3 for more detail concerning this recommendation.
[8] The Energy Division should hold a workshop to flesh out the details of the required revenue accounting.

17. PG&E's EDR eligibility requirements should be tightened to include more protections for non-participating ratepayers. Enhanced EDR customers should be prohibited from serving two 5-year terms on the enhanced-EDR rate schedule. Enhanced and standard EDR customers should be allowed to reapply for a second 5-year term on the standard-EDR rate schedule only. The EDR customer contract should include a non-assignment clause. A liquidated damages clause should also be included in the EDR customer contract for customer initiated early termination of EDR contracts.

DRA's recommendations are compared with the current EDR program in Tables ES-2 and ES-3.

Table ES-2: Current EDR vs. DRA's Proposals: Rates and Price Floors

Current EDR	DRA Proposal
Standard 12% Discount, 5-year term	Standard 12% Discount, 5-year term
No enhanced discount option	Declining discount for high unemployment areas, i.e. 35%-30-20-15-10%; 5-year term
<u>Additive</u> floor price based on Marginal cost + NBC Rate Components, enforced annually, ex ante & ex post	**<u>NBC Rates</u>**: Floor price includes NBCs, including all transmission charges and DRW bond charges. Applies annually. **<u>Modified Additive</u>** Floor prices based on NBCs + Marginal distribution cost + Marginal energy cost; floor price applies to 5-year NPV (ex ante only). **<u>Marginal Cost:</u>** Floor prices based on full marginal cost including generation capacity; floor price applies to 5-year NPV (ex ante only). (Five year CTM > 0)
CTM cannot be negative in any year	Net present value of CTM must be positive over 5-year contract term
Annual ex post back billing to recover negative CTM from customer	No ex post recovery from customer
Distribution constrained by marginal cost floor	Distribution constrained by marginal cost floor
Generation constrained by marginal cost floor	Net present value of generation CTM must be positive over 5-year contract term
No discounting of NBC Rate Components (including Transmission)	No discounting of NBC Rate Components (including Transmission)
No PG&E shareholder participation	PG&E shareholders bear 25% of discount PG&E shareholders bear 100% of negative 10-year CTM
200 MW cap	200 MW cap

Table ES-3: Current EDR vs. DRA's Proposals: Eligibility and Contract Terms

Current EDR	DRA Proposal
• Approval of applicants by CalBIS required; • limit participation to customers whose energy costs are at least 5% of operating costs, • implement with an affidavit provision; • require PG&E to conduct energy audit of the applicant's facility & create a checklist of EE/ conservation measures applicable to applicant.	• Approval of applicants by CalBIS required; • limit participation to customers whose energy costs are at least 5% of operating costs, • implement with an affidavit provision; • require PG&E to conduct energy audit of the applicant's facility & create a checklist of EE/ conservation measures applicable to applicant, require audit submittal to Commission in EDR Annual Reports & reasoning for not implementing each EE/ conservation measure
Assignment of Contracts permissible only if PG&E consents in writing and the party to whom the agreement is assigned agrees in writing to be bound by the EDR agreement in all respects	Prohibit the transfer of an EDR contract if a company is sold. The purchasers of a company that was an EDR customer must reapply for the program.
EDR contracts can be renewed for one additional 5-year term.	Prohibit Enhanced EDR customers from applying for a second Enhanced EDR term. Enhanced & Standard EDR customers can reapply for a second 5-year term in the Standard EDR program
Liquidated damages clause for customer fraud or misrepresentation	Liquidated damages clause for customer fraud or misrepresentation and a separate liquidated damages clause for customer initiated early termination of EDR contract

III. DISCUSSION

A. PG&E PROPOSES TO REMOVE MANY OF THE RATEPAYER SAFEGUARDS IN THE CURRENT EDR PROGRAM

PG&E proposes to eliminate the price floor provisions in the current EDR and weaken the current applicant screening and eligibility requirements. PG&E states that its proposed customer eligibility standards for the new EDR program are similar to those in the current Schedule ED. PG&E proposes that Applicants will continue to sign an affidavit, under penalty of perjury, that "but for" the EDR incentive, either on its own or in combination with a package of other economic development incentives, the customer would not have located or retained the load in the state of California. However, unlike the current Schedule ED, PG&E now seeks authority to determine EDR eligibility without prior approval by CalBIS or another third party. PG&E's proposed changes would give PG&E sole discretion over EDR eligibility, and make it easier for customers to qualify. DRA believes that these changes would increase the risk of loss to ratepayers due to free-riders, and therefore opposes the proposed changes to the eligibility requirements.

PG&E's proposed elimination of the EDR floor price amounts to "throwing out the baby with the bath water". DRA accepts that some changes to the current floor price may be warranted, and sets forth a modified floor price proposal below. However, as discussed herein, retention of a floor price is essential to meeting the statutory test of "ratepayer benefit" for an EDR program.

Table ES-1 summarizes the difference between the current EDR program and PG&E's EDR proposals.

B. DRA PROPOSES EDR PROGRAMS THAT APPROPRIATELY BALANCE BENEFITS AND RISK

DRA recognizes the need for changes to the current EDR floor prices in order to allow PG&E to provide meaningful discounts to "at risk" customers during the current economic emergency. In response to customer need, DRA proposes to replace the current additive EDR price floor[9] with a combination of three less stringent price floors:

- a nonbypassable rate floor applied annually,
- a marginal cost floor applied over the 5-year contract term, and
- a modified additive price floor, also applied over the 5-year contract term.

These pricing floors are embodied in DRA recommendation Nos. 3, 4, and 5 above, and would allow up to a 35% discount in the initial year of a 5-year contract. DRA's floor price proposals are described in greater detail in Chapter 2.

DRA notes that PG&E's proposed Enhanced EDR Option would produce negative CTM over the proposed 5-year contract term[10]. This would violate DRA's proposed marginal cost price floor. DRA also notes that PG&E proposes negative distribution

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[9] The sum of the nonbypassable charges and marginal costs.

rates that would, in some cases, effectively discount NBC rate components. For these reasons, among others, DRA proposes to remedy PG&E's Enhanced EDR proposal by reducing the initial 35% discount each year over the 5-year contract term. DRA's proposed Enhanced EDR Option rates achieve a positive CTM over the 5-year contract period and avoid negative distribution rates.

Tables ES-2 and ES-3 summarizes the differences between the current EDR program and DRA's EDR proposals.

C. DRA PROPOSES THAT PG&E SHAREHOLDERS BEAR SOME OF THE RISK OF EDR-RELATED REVENUE SHORTFALL AND NEGATIVE CTM

DRA believes that its rate proposals mitigate much of the considerable risk created by PG&E's EDR proposals. However, significant risks remain, compared to the current EDR program, because the Enhanced EDR involves a larger discount and because marginal cost floor prices would no longer be enforced annually. Currently, customer bills are adjusted annually on an ex post basis to avoid negative CTM. Under PG&E's proposal, the risk of negative CTM is shifted from participating customers to nonparticipating ratepayers.

If implemented carefully, PG&E's proposals, modified as recommended by DRA, would provide benefits relative to the current EDR program. These include increased customer participation and increased CTM. Because both ratepayers and shareholders stand to benefit from a successful EDR program[11]; both should share in the increased risk needed to achieve these benefits. Accordingly, DRA recommends that shareholders be required to bear 25% of the cost of the EDR discounts.[12]

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[10] For bundled service customers located in areas with distribution constraints.

[11] As discussed above, positive CTM exerts downward pressure on rates; and sales and revenue growth exert upward pressure on stock prices.

[12] This recommendation is contingent on adoption of EDR with a floor price substantially as recommended by DRA. In the alternative, if the Commission adopts an EDR with *no* floor price as recommended by PG&E, then DRA recommends 50% PG&E shareholder participation in EDR discounts.

In addition, ratepayer benefit under Public Utilities Code ("PU Code") § 740.4(h) requires a positive CTM, as established in Chapter 1 of this Testimony. Accordingly, if the EDR program results in a negative CTM, then ratepayers will not benefit from the program and costs from the program are not eligible for rate recovery. If program costs cannot be recovered through rate recovery under PU Code § 740.4(h), then PG&E shareholders are responsible for funding the entire negative CTM. If PG&E is not able to show a ratepayer benefit from its EDR portfolio in the form of a positive CTM within 10 years from the start of the EDR program, then the Commission should require PG&E shareholders to pay for 100% of the negative CTM.

PG&E is proposing a radical change to the current EDR paradigm in this proceeding. Currently, participants pay for any negative CTM.[13] Under PG&E's proposed new paradigm, nonparticipating ratepayers would bear the cost of negative CTM. However, State law requires that PG&E shareholders, not non-participating ratepayers, pay for the negative CTM in order to assure compliance with the ratepayer benefit provision in PU Code § 740.4(h).

IV. ORGANIZATION OF TESTIMONY

Chapter	Subject	DRA Witness
1	Economic Development Rate Policy	R. Levin & E. Torres
2	EDR Discounts and Floor Prices	R. Levin
3	EDR Eligibility, Ratepayer Protection, and Funding	E. Torres

[13] Customers are back-billed, if necessary, for any increases the marginal energy cost that occur while their EDR contract is in effect.

On August 7, 2012, Assigned Commissioner Ferron issued a Scoping Ruling with questions directed at the parties.   DRA's responses to these questions are attached as Appendix B. The following lists the various appendices to this testimony:

Appendix	Subject	DRA Witness
A	Witness Statements of Qualifications	R. Levin & E. Torres
B	DRA Responses to August 7, 2012 ACR Questions	R. Levin & E. Torres
C	CalBIS Qualification Form	E. Torres
D	PG&E EDR Annual Reports	E. Torres
E	Data Request Responses Cited in Testimony	E. Torres
F	Miscellaneous Documents Cited in Testimony	E. Torres
G	Contribution to Margin from PG&E and DRA Proposals	R. Levin
H	Present Value Margin Above Modified Additive Price Floor	R. Levin
I	DRA Proposed Rates and Price Floors	R. Levin

V. CONCLUSION

The EDR program has the potential to be a useful economic development tool if administered correctly. PG&E's proposed EDR program subjects nonparticipating ratepayers to an unnecessarily large amount of risk. In the following chapters, DRA proposes many changes to the EDR program that will protect ratepayers and ensure the effective and efficient administration of the EDR program.