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Decision 84 07 071 JUL 5 1984 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SOUTHERN CALIFORNIA GAS COMPANY and PACIFIC LIGHTING GAS SUPPLY COMPANY for Authority to Revise Gas Rates and Tariffs Effective May 1, 1984, under the Consolidated Adjustment Mechanism.	Application 84-03-30 (Filed March 9, 1984)

(See Appendix A for appearances.)

INTERIM OPINION

Applicants Southern California Gas Company and Pacific Lighting Gas Company (SoCal) have requested expedited consideration of its proposed GN-7 rate applicable to enhanced oil recovery (EOR) facilities. The proposed GN-6 schedule for food processors should also be decided early in the food processing season.

Currently under certain Federal Energy Regulatory Commission (FERC) pricing rules, the price for natural gas for use as a boiler fuel cannot be lower than certain alternate fuel price standards. These prices are published monthly. The current minimum price is 40 cents per therm. In order for a utility to sell gas below this price, it must be granted an adjustment or an exemption from these FERC pricing rules. It is SoCal's position that it would be most helpful to have the approval of this Commission to charge its proposed rate of 38¢/therm before seeking approval on the federal level.

SoCal proposes to provide gas, to facilities which produce EOR steam, at 5¢ above SoCal's available cost as long as these EOR facilities are capable of burning heavy crude oil as its alternate fuel. The five-cent differential was proposed by SoCal after review of:

1. Several other similar gas rates across the country.
2. Surveying pipeline rates for bare transportation.
3. The rates it charges its own gas exchange customers.

SoCal believes that the five cents is a reasonable contribution to margin.

SoCal has forecasted that its incremental gas source for the forecast period will be El Paso discretionary gas. SoCal then calculates its avoidable cost for this gas by taking only the commodity cost of El Paso gas then subtracting a portion of a surcharge that is incorporated in the El Paso commodity charge. This surcharge is referred to as the Account 191 surcharge and is similar to the Consolidated Adjustment Mechanism (CAM) balancing account in our scheme of regulation. The result of the calculation is a GN-7 rate of 38¢/therm. We have previously allowed such a calculation for gas sequencing purposes but never for rate design purposes. The 38¢/therm rate at projected sales of 365,000 therms per year then produces a $17.5 million benefit for the ratepayers, if we were to agree with SoCal's calculations.

Staff Position

The Rate Design and Economics Branch of the Utilities Division takes the position that it is desirable to have all sales result in at least a five-cent contribution to margin. However, it further states that if the cost of discretionary gas includes the Account 191 surcharge a rate which yields less than a five-cent differential is necessary in order to make sales under the proposed GN-7 schedule.

The Fuels and Operations witness Casey is willing to assume that a five-cent differential between the cost of incremental supply and lowest sales price is reasonable but disagrees with SoCal over how to compute the cost of the incremental gas supply. Casey shows that while SoCal's computation is proper for gas sequencing, it is improper for rate design purposes. Casey states that the full commodity cost of the incremental supply should be the basis to which the five-cent differential is added. Staff witness Casey also testifies that approval of the 38¢ rate would indicate to producers that they are currently pricing their gas appropriately. On the other hand, if we do not allow the 38¢ rate and insisted on a higher minimum floor rate, then we would be indicating to the gas producers that if this new gas market is to be served, then the price of wellhead gas price must be reduced so that the utility can price its gas to these customers at competitive alternate fuel price levels (crude oil) and still enjoy a reasonable minimum contribution to margin.

Discussion

Before we more fully discuss this proposal, certain facts will put the proposal into a better perspective:

1. SoCal's system average rate equals 54.6¢/therm.
2. Average rate for customers without alternate fuel capacity (Residential, GN-1 and GN-2a) equals 63.62¢/therm.
3. SoCal's system average cost of gas equals 40.7¢/therm.
4. 365,000 M-therms is about 4% of total system sales and about equals the GN-3 and GN-4 market.

In order to analyze this rate proposal, we must look at the benefits and detriments to the other ratepayers. SoCal calculates the net benefit to other ratepayers to be equal to $17.2 million. In its calculation, however, SoCal uses the artificially low avoidable costs. The staff, however, argues that the total commodity cost of gas should be that basis of rate design. Using the commodity cost of incremental gas at the full forecast sales produces a net benefit of $6.04 millon.

To understand the significance of this $6.04 million benefit, we must examine its effects on the rates of customers without alternate fuel capability. Currently the average rate for these customers (Residential, GN-1 and GN-A) is 63.62¢/therm. If we were to direct the $6 million benefit to only these customers, the effect would be to reduce the average rate from 63.62¢/therm to 63.47¢/therm or about one and a half tenths of a cent. It is apparent that the sale of this very large amount of gas as proposed produces very little benefit to other ratepayers.

There are two apparent detriments of the proposal. First, as so-called low-cost old gas is exhausted, the average cost of gas paid by El Paso to producers could increase at a faster rate. Unfortunately, no one could quantify this detriment. The second, and more important result of approving this rate, is that our approval would send a price signal to the gas producers. Approval of the rate would indicate our approval of the current prices paid by El Paso to producers. On the other hand, disapproval would indicate that we are not satisfied with the price structure that requires SoCal to have a high system average rate in excess of 54¢/therm while the market clearing price is probably somewhat below 50¢/therm.

At this point we reach the conclusion that the 38¢ proposed EOR rate offers fewer benefits than detriments. The question remaining is what rate level is reasonable for this service. SoCal has proposed a 5¢ differential based upon the sequencing price of El Paso gas. The staff, however, has persuasively demonstrated that the total commodity cost of incremental gas, not the sequencing price, should be used for rate design purposes. Applying the 5¢ differential to the full commodity cost results in a rate that SoCal believes will not detract EOR sales. The staff's rate design witness would have us approve less than the 5¢ differential to make an attractive rate. The record in this case does not provide us with the facts necessary to determine a minimum acceptable differential.

While SoCal's proposal included the 5¢ differential which was not opposed by either the staff or any intervenors, we will not adopt a specific differential as a reasonable minimum at this time. Rather, we will adopt a commodity rate of 40.0¢/therm which appears reasonable when looking at SoCal's average cost of gas of 40.1¢/therm, the FERC incremental pricing standard of 40¢/therm, and PG&E's G59 minimum bid rate of 40¢/therm.

Food Processor Rate (GN-6)

The second rate proposal that requires expedited consideration is the proposed GN-6 rate. This rate is to be applicable to food processors which have No. 6 fuel oil capability. The proposed rate is 48¢/therm inside the South Coast Air Quality Management District and 44¢/therm outside the district. The rate also features economic curtailment in the event that SoCal's price of gas (commodity cost of incremental supply plus five cents) rises above the GN-6 rate in which event service would be provided under the normally applicable schedule GN-36/46. The company estimates increased sales of about 3 Bcf per year and an additional margin contribution of $2.4 million. This rate proposal is supported by the California League of Food Processors (CLFP), TURN, and the Commission staff. This special rate was opposed by the California Manufacturers Association (CMA).

Discussion

Much of our analysis of this rate is the same analysis discussed in reference to the GN-7 rate above and will not be repeated. In weighing the benefits and detriments, we see that the rate will always produce a reasonable contribution to margin. This is the case because there are many food processors who have switched to fuel oil who will return to the gas system at this lowered rate. The greater sales volume even at this low rate will produce a greater contribution to margin from this group of customers than if we retained the current rate. Thus, two important criteria are met - (1) positive contribution to margin and (2) a rate which is at a reasonable level above the commodity cost gas. At the proposed rate level the improper price signal to producers discussed earlier is not an issue.

The major detriment to this proposal was raised by CMA in the following excerpt of its brief:

> "Special rates, such as that proposed for food processors, should be rejected. They evidence an intent to continue piecemeal answers which in reality provide no real long term solution. Furthermore, the food processors' rate is unfairly discriminatory against other customers who have the same fuel use characteristics, the same competitive alternate fuel costs or value of service, and impose the same cost burdens on the utility but who are not eligible for the special rate merely because they are not food processors.
>
> "This rate is not like the ammonia producer rate which the Legislature mandated in order to retain fertilizer production in California. There is no showing in support of the food processors rate other than a threat to fuel switch if the rate is not forthcoming. To be non-discriminatory, the rate would have to be available to all customers who would switch to an alternate fuel without the lower rate. This concept SoCalGas has rejected."

The basic issue is rate targeting. In other words the issue is should there be different rates applicable to similarly situated different end use groups? Admittedly, this practice is not desirable but we believe, at this time, a necessary practice. Our basic policy is that all customers should pay as close to the utility's marginal cost as possible. It would be ideal if all customers could be priced at an equal relationship to marginal cost but because of the alternate fuel capability of some customers their rates must be capped at the price of the alternate fuel. There is not one single price at which all potential fuel switchers will change fuels. Rather, there seems to be a range that runs from the low end of the alternate fuel price range to a price somewhat above the price of the high end of the alternate fuel price range. It is this phenomenon which allows us to target industrial rates without being unduly discriminatory. In essence we are balancing the equities to other customer classes by recognizing the degree of divergence from marginal costs of the rates for the other classes. This is not an engineering or formulistic approach but rather ratemaking as an art. This approach will be required until the revenue requirement and marginal cost revenues are in closer proximity.

It should be noted that our adoption of the GN-6 schedule is not an indication that we are moving in the direction of end use rates. We view our actions here as a temporary solution and direct SoCal and our staff to address other methods for resolving this issue in SoCal's November CAM. Furthermore, we will only authorize this schedule for the current season which concludes November 30, 1984.

Findings of Fact

1. A GN-7 rate of 38¢/therm will result in additional sales of 365,000 Mtherms per year and a contribution to margin of about $6 million.

2. The full commodity cost of SoCal's incremental supply is appropriate for rate design purposes.

3. A five-cent differential above the full commodity cost of incremental supply is a desirable minimum price for gas sales.

4. A GN-7 rate of 40¢/therm is reasonable at this time.

5. Exclusive of the rate level, the GN-7 rate schedule as proposed by SoCal is reasonable.

6. The proposed GN-6 rate schedule will produce additional sales of 3 Bcf per year and additional margin contribution of about $2.4 million.

7. The GN-6 rate levels of 44¢/therm outside the South Coast Air Quality Management District and 48¢/therm inside the district are reasonable.

8. Both GN-6 and GN-7 are in effect rate reductions.

9. The GN-6 rate schedule as proposed is reasonable.

10. The food processing season has started and will run through October. For this reason we will make the order effective today.

Conclusion of Law

The GN-7 and GN-6 rates as discussed here are just and reasonable and should be authorized.

INTERIM ORDER

IT IS ORDERED that Southern California Gas Company is authorized to file revised tariffs implementing the GN-7 and GN-6 rate schedules as discussed in this order on or after the effective date of this order to be effective not less than five days after the effective date of this order.

This order is effective today.

Dated July 5, 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I Dissent.

/s/ PRISCILLA C. GREW
Commissioner

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz, Executive Director

APPENDIX A

List of Appearances

Applicants: David B. Follett, Peter N. Osborn and Frederick E. John, Attorneys at Law; and Robert B. Keeler, Jeffrey E. Jackson, and Frederick E. John, Attorneys at Law, for Southern California Gas Company and Pacific Lighting Gas Supply Company.

Protestants: Herman Mulman, for Seniors for Political Action; and Edward Duncan, for himself.

Interested Parties: William L. Knecht, Attorney at Law, by Phil Presber, Attorney at Law, for California Association of Utility Shareholders; Brobeck, Phleger & Harrison, by Gordon E. Davis and Richard D. Harper, Attorneys at Law, for California Manufacturers Association; Robert L. Pettinato, for Los Angeles Dept. of Water & Power; Thomas George Wagner and Earle H. Mowrey, for Transwestern Pipeline Company; Richard K. Durant and H. Robert Barnes, Attorneys at Law, for Southern California Edison Company; E. D. Yates, for California League of Food Processors; Gerald J. La Fave, Attorney at Law, for California Farm Bureau Federation; William L. Reed, Wayne P. Sakarias and Jeffrey Lee Guttero, Attorneys at Law, for San Diego Gas & Electric Company; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for City of San Diego; Ira Reiner, City Attorney, by Ed Perez, Deputy City Attorney, for City of Los Angeles; Chadbourne, Parke, Whiteside, and Wolff, by Jerry R. Bloom, Attorney at Law, for Kimberly-Clark Corporation; Richard L. Hamilton, Attorney at Law, for Western Mobilehome Association; Robert W. Parkin, City Attorney, by Richard A. Alesso, Deputy City Attorney, for City of Long Beach; Robert O. Randall, for Suburban Water Systems; Wayne L. Meek, for Simpson Paper Company; Harry K. Winters, for University of California; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr, Attorney at Law, for Federal Paper Board Company, Inc; Sutherland, Asbill and Brennan, Attorneys at Law; Edward J. Grenier, Jr. and Earle H. O'Donnell; and General Motors Corporation; Raymond E. Heytens, for San Gabriel Valley Water Company; Sylvia M. Siegel and Michel Peter Florio and Jon F. Elliott, Attorneys at Law, for TURN; Kuhs & Parker, by William C. Kuhs, Attorney at Law, for Tehachapi-Cummings County Water Distirct; and Henry F. Lippitt, 2nd, Attorney at Law, for California Gas Producers Association.

Commission Staff: Arcoles Aguilar and James Rood, Attorneys at Law, and Geoffrey W. Meloche and Raymond A. Charvez.

To understand the significance of this $6.04 million benefit, we must examine its effects on the rates of customers without alternate fuel capability. Currently the average rate for these customers (Residential, GN-1 and GN-A) is 63.62¢/therm. If we were to direct the $6 million benefit to only these customers, the effect would be to reduce the average rate from 63.62¢/therm to 63.47¢/therm or about one and a half tenths of a cent. It is apparent that the sale of this very large amount of gas as proposed produces very little benefit to other ratepayers.

The two apparent detriments of the proposal is that as so-called low-cost old gas is exhausted then the average cost of gas paid by El Paso to producers could increase at a faster rate. Unfortunately, no one could quantify this detriment. The second, and more important result of approving this rate, is that our approval would send a price signal to the gas producers. Approval of the rate would indicate our approval of the current prices paid by El Paso to producers. On the other hand, disapproval would indicate that we are not satisfied with the price structure that requires SoCal to have a high system average rate in excess of 54¢/therm while the market clearing price is probably somewhat below 50¢/therm.

At this point we reach the conclusion that the 38¢ proposed EOR rate offers fewer benefits than detriments. The question remaining is what rate level is reasonable for this service. SoCal has proposed a 5¢ differential based upon the sequencing price of El Paso gas. The staff, however, has persuasively demonstrated that the total commodity cost of incremental gas, not the sequencing price, should be used for rate design purposes. Applying the 5¢ differential to the full commodity cost results in a rate that SoCal believes will not detract EOR sales. The staff's rate design witness would have us approve less than the 5¢ differential to make an attractive rate. The record in this case does not provide us with the facts necessary to determine a minimum acceptable differential.

While SoCal's proposal included the 5¢ differential which was not opposed by either the staff or any intervenors, we will not adopt a specific differential as a reasonable minimum at this time. Rather, we will adopt a commodity rate of 40.0¢/therm which appears reasonable when looking at SoCal's average cost of gas of 40.1¢/therm, the FERC incremental pricing standard of 40¢/therm, and PG&E's G59 minimum bid rate of 40¢/therm.

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Discussion

Much of our analysis of this rate is the same analysis discussed in reference to the GN-7 rate above and will not be repeated. In weighing the benefits and detriments, we see that the rate will always produce a reasonable contribution to margin. This is the case because there are many food processors who have switched utility's marginal cost as possible. It would be ideal if all customers could be priced at an equal relationship to marginal cost but because of the alternate fuel capability of some customers their rates must be capped at the price of the alternate fuel. There is not one single price at which all potential fuel switchers will change fuels. Rather, there seems to be a range that runs from the low end of the alternate fuel price range to a price somewhat above the price of the high end of the alternate fuel price range. It is this phenomenon which allows us to target industrial rates without being unduly discriminatory. In essence we are balancing the equities to other customer classes by recognizing the degree of divergence from marginal costs of the rates for the other classes. This is not an engineering or formulistic approach but rather ratemaking as an art. This approach will be required until the revenue requirement and marginal cost revenues are in closer proximity.

As we have discussed, this new rate schedule will produce greater revenues to the company even though the rate change is in effect a rate reduction. In addition to the fact that these proposals are rate reductions, the fact that the food processing season is now underway constitutes a sufficient emergency to authorize these rates without the usual 10 days' agenda notice.

However, it should be noted that our adoption of the GN-6 schedule is not an indication that we are moving in the direction of end use rates. We view our actions here as a temporary solution and direct SoCal and our staff to address other methods for resolving this issue in SoCal's November CAM. Furthermore, we will only authorize this schedule for the current season which concludes November ~~1~~ 30, 1984. wb

Findings of Fact

1. A GN-7 rate of 38¢/therm will result in additional sales of 365,000 Mtherms per year and a contribution to margin of about $6 million.

2. The full commodity cost of SoCal's incremental supply is appropriate for rate design purposes.

3. A five-cent differential above the full commodity cost of incremental supply is a desirable minimum price for gas sales.

4. A GN-7 rate of 40¢/therm is reasonable at this time.

5. Exclusive of the rate level, the GN-7 rate schedule as proposed by SoCal is reasonable.

6. The proposed GN-6 rate schedule will produce additional sales of 3 Bcf per year and additional margin contribution of about $2.4 million.

7. The GN-6 rate levels of 44¢/therm outside the South Coast Air Quality Management District and 48¢/therm inside the district are reasonable.

8. Both GN-6 and GN-7 are in effect rate reductions.

9. The GN-6 rate schedule as proposed is reasonable.

10. The food processing season has started and will run through October. This constitutes a sufficient emergency to warrant immediate approval of this portion of Application 84-03-30.

<u>Conclusion of Law</u>

The GN-7 and GN-6 rates as discussed herein are just and reasonable and should be authorized.

INTERIM ORDER

IT IS ORDERED that Southern California Gas Company is authorized to file revised tariffs implementing the GN-7 and GN-6 rate schedules as discussed in this order on or after the effective date of this order to be effective not less than five days after the effective date of this order.

This order is effective today.

Dated JUL 5 1984, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

I dissent.
PRISCILLA C. GREW, Commissioner

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY.

Joseph E. Bodovitz, Executive Director