

ORIGINAL

Decision 89 02 071 FEB 24 1989

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Investigation on )  
the Commission's own motion into the )  
interstate natural gas pipeline )  
supply and capacity available to )  
California. )

I. 88-12-027

INTERIM OPINION

I. INTRODUCTION

On December 19, 1988, the Commission commenced this proceeding with an Order Instituting Investigation (OII) for the purpose of encouraging the development of proposals to address the question of new natural gas pipeline capacity for the State of California. On February 1, 1989, the deadline for responses by the respondent energy utilities, one Joint Response and five individual responses were filed by the utilities. One day later, a settlement agreement between Southern California Gas Company (SoCalGas) and the Kern River Gas Transmission Company (Kern River) was filed with the Commission. These filings, while not comprising a global settlement to the question of new pipeline capacity, have significantly advanced the resolution of this issue.

The Commission, through this Interim Opinion, intends to clarify the procedural steps which it believes will bring the process of defining the market for new capacity to its logical conclusion. In so doing, the Commission will ensure that all interested parties will play an important role in the final development of a Commission policy for new pipeline capacity for California. In addition, the Commission has concluded that an

improved level of service for non-core gas customers<sup>1</sup> is warranted by the record in this and other Commission proceedings and directs the respondent utilities to formulate specific proposals for providing that higher level of service which is demanded by the non-core market.

The Commission is encouraged by the diligence with which the many parties conducted intensive discussions in an attempt to conclude an overall settlement in this most difficult and complex matter. It appears that with a similar effort over the next 60 days it will be possible to define the actual market demand for new capacity and to develop proposals to meet that demand. That is the goal of the Commission in issuing this Interim Opinion.

## II. POSITIONS OF THE RESPONDENT UTILITIES

### A. Joint Utility Response

The respondent utilities, Pacific Gas & Electric Company (PG&E), SoCalGas, Southern California Edison Company (Edison), Southwest Gas Corporation, and San Diego Gas & Electric Company (SDG&E) conferred as directed in Ordering Paragraph No. 4 of I.88-12-027 and determined to file a joint response as well as individual responses to the order. The utilities concluded that under "certain circumstances", which were not specified, that additional pipeline capacity can be economically justified. The utilities do not agree on the amount, if any, of new firm capacity which can be economically justified, and have determined that they will not jointly select a preferred project or alternative.

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1. Non-core gas customers are generally defined as those customers having an annual demand in excess of 250,000 therms per year and which also possess alternative fuel capability.

On the related subject of firm capacity rights, the utilities state that there is a need for greater access to firm capacity rights for non-core customers given the emerging gas industry structure. In addition, the utilities conclude that projected load factor should not be the single criterion for assessing the justification for new pipeline capacity considering the importance of operating flexibility, supply diversity, and gas-on-gas competition. The respondent utilities also indicated that, in varying degrees, curtailment, the use of storage, and changes in regulatory policy to increase non-core access to firm capacity and firm storage rights or to liberalize non-core procurement options can diminish the need for new pipeline capacity.

#### B. PG&E

Citing the need for supply diversity, and the demand for additional firm capacity rights, PG&E maintains that new pipeline capacity is needed in California. In its proposal PG&E targets two markets for new capacity: the Southern California utility market, and incremental portions of the Kern County EOR market.

##### 1. Southern California

PG&E proposes the Pacific Gas Transmission Company (PGT)/PG&E Expansion Project to meet the needs of the Southern California utility market. The project would connect Southern California utilities to the Western Canada gas supply region by expanding the existing PGT and PG&E systems. PG&E's project involves completing the looping on PGT's existing pipeline within its existing right-of-way to its connection with PG&E at Malin, Oregon, and a looping of portions of PG&E's existing transmission system from Malin to Panoche Station. From that point, the gas will be delivered by displacement on PG&E's

existing Line 300. At PG&E's Kern River Station, gas will be delivered to the transmission and distribution system of SoCalGas for subsequent delivery in Southern California. PG&E projects that the expansion will provide 600 MMcf/d of new firm capacity.

PG&E argues that the Expansion Project is consistent with the Commission's objectives. In particular the project would provide additional supply diversity, encouraging gas-on-gas competition and lessening Southern California's dependence on the El Paso and Transwestern pipelines. PG&E does not propose to bypass SoCalGas' distribution system, and foresees that the costs involved will be borne by the new customers on the system. The PG&E portion of the project would be under CPUC jurisdiction, while the PGT portion would be regulated by the Federal Energy Regulatory Commission (FERC).

## 2. Kern County EOR Market

PG&E proposes two options to serve EOR producers insisting on new FERC-regulated interstate capacity. The first is construction of incremental capacity additions to PG&E's existing Line 300 from the California/Arizona border through Kern County. Such an expansion would be FERC-regulated, and sized and timed according to EOR shippers' capacity contracts. The second option is construction of a FERC regulated stand-alone pipeline parallel to Line 300, constructed and operated by a FERC-regulated entity. PG&E believes that contracts for at least 400 MMcf/d of capacity are required to make this option economically viable. Jurisdiction over the new capacity under these options would revert to the Commission upon termination of the individual EOR shipper contracts.

PG&E opposes the major alternatives to additional pipeline capacity. Specifically, PG&E argues that reallocation of firm capacity rights on existing systems would hurt core customers by preventing utilities from utilizing the full system capacity to manage costs for the core customers on a least cost

basis. In addition PG&E believes curtailment is an inadequate solution given the level of service demanded by utility customers.

### C. SoCalGas

SoCalGas reaches no definitive conclusion on the necessity for new pipeline capacity additions in California. Rather it emphasizes the high level of service it has provided and leaves it to the Commission and the utility customers to determine whether a higher level of service is required. SoCalGas outlines its plan to improve its level of service within the existing pipeline capacity, as well as its proposal to increase pipeline capacity if additional capacity is required.

Working within existing capacity SoCalGas recognizes that non-core customers are demanding greater access to firm deliverability. To meet these demands SoCalGas is working on a system of capacity assignment agreements with wholesale and UEG customers. Letters of intent to contract for an assignment of firm capacity have been submitted to SoCalGas by SDG&E and the City of Long Beach and other negotiations are in progress. SoCalGas emphasizes that this plan will lead to greater gas-to-gas competition and reduce the likelihood of bypass of the existing utility system.

In the event the Commission decides that additional pipeline capacity is needed, SoCalGas proposes an incremental expansion of SoCalGas' existing system. The additions would consist of facilities to be constructed at the California-Arizona border and would increase SoCalGas' ability to receive gas through the El Paso, Transwestern, Northwest, and PGT systems. Additional capacity of up to 400 MMcf/d could be provided under the project for a cost of between \$100-125 million.

SoCalGas believes that the capital costs involved in its proposal are substantially less than any of the larger pipeline projects, and that its proposal has the advantage of

faster completion in 100 MMcf/d increments. In addition, SoCalGas argues that proposals resulting in more than 400 MMcf/d in additional capacity may be uneconomic since the capacity would be underutilized.

Regarding the EOR market, SoCalGas maintains it has been meeting the producers' needs, and will continue to compete in the event the EOR market is served by a new interstate pipeline.

One significant development occurred the day after SoCalGas filed its Feb. 1 response to I.88-12-027. On Feb. 2, SoCalGas filed a supplement to its response in the form of a settlement agreement between itself and Kern River Gas Transmission Company. The agreement provides that Kern River shall amend its certificate application with the FERC to conform to the agreement, including commitments to deliver all non-EOR gas into SoCal's distribution system for delivery, and to give SoCalGas a right of first refusal for all capacity rights not utilized by EOR customers. In addition, Kern River commits to obtain pregranted abandonment authority from the FERC for its facilities within the State of California and to bring those facilities within the jurisdiction of the CPUC after 20 years of service under Section 1(c) of the Natural Gas Act. The agreement is contingent upon the CPUC agreeing to waive the contract modification provisions of General Order No. 96-A for EOR contracts in force when the jurisdictional reversion occurs. Further SoCalGas and Kern River pledge to hold each other harmless from and to refrain from litigation against each other arising out of the pipeline project. The parties have reserved six months to obtain contracts sufficient to make the project viable and to identify the appropriate SoCalGas delivery points. Clearly, this agreement is designed to bring the Kern River project within the criteria of I.88-12-027, and on its face, this agreement does not conflict with the criteria, although other conditions remain to be met, such as economic justification of the proposed additional capacity.

## D. Edison

Edison has not developed a comprehensive gas transportation proposal at this time. The utility cites a number of limitations to its response to the OII including the lack of a regulatory framework for comparing alternatives, and uncertainty over prices and costs.

Edison believes that a new capacity addition of up to 400 MMcf/d for all of Southern California is economically justified. Although Edison foresees no increase in its gas usage, it is impacted by the demands of higher priority customers. In addition Edison maintains that the benefits of increased gas-to-gas competition outweigh the costs of increased capacity. Edison argues that the lower capacity factor which would result from the additional pipeline capacity is reasonable considering the current structure of the gas market.

Edison executed a letter agreement with PGT indicating that it is contemplating acquiring 200 MMcf/d of firm capacity on the proposed PGT/PG&E expansion. Edison concludes that the PGT/PG&E expansion would meet the Commission's criteria more fully than any other project currently proposed. However, Edison continues to evaluate alternatives and is open to reevaluating one or more of the other projects if terms satisfying the Commission's criteria concerning bypass were established.

Edison is also negotiating with SoCalGas for access to firm transportation capacity on SoCalGas' existing lines. These negotiations do not alter Edison's position on the need for additional capacity.

## E. SDG&amp;E

SDG&E supports additional pipeline capacity because it seeks to obtain firm interstate capacity rights. Although SDG&E is on the verge of contracting with SoCalGas for an allocation of

firm capacity SDG&E still believes additional pipeline capacity can be economically constructed.

SDG&E is not currently endorsing any particular pipeline project, and believes its interests are too small to influence the choice of one particular project. However, SDG&E does not believe that more than 700 MMcf/d of additional capacity can be justified. SDG&E itself is interested in obtaining 100 MMcf/d of capacity to a new supply area, of which only 25 to 50 MMcf/d would be truly incremental capacity while the remainder would displace load on existing systems.

#### F. Southwest Gas

Southwest has endorsed no pipeline project and does not endeavor to determine the state's overall need for additional pipeline capacity. Southwest explains that its market in California is small and a significant portion of its service territory is located outside California. As a result, any decision by Southwest to participate in a pipeline project would be dominated by the interests of its non-California operations.

### III. THE STATE OF THE MARKET FOR NEW PIPELINE CAPACITY

#### A. The Status of Projects Proposed to Serve the California Market

It is worth reviewing all the various proposals which have been made to provide new or enhanced pipeline service to California. We can divide the proposals into three categories: new interstate pipelines, expansions or enhancements of existing interstate or intrastate pipelines, and proposals to provide greater access to existing firm capacity.



## 1. New Interstate Pipeline Proposals

The Mojave Pipeline Company (Mojave) has an application for a certificate under Section 7(c) of the Natural Gas Act pending before the FERC. Hearings on both the environmental and non-environmental issues have been concluded and briefs have been submitted. In addition, Mojave has filed an Optional Certificate (OC) application with the FERC which proposes an array of new projects, including a smaller scale 400 MMcf/d line from Topock to Kern County. No action has been taken by the FERC on the Mojave OC application to date.

Mojave has not submitted any agreement or settlement with California utilities to indicate that it intends to conform to the criteria set forth in I.88-12-027. Mojave must still be considered a bypass pipeline which intends to operate under wholly federal jurisdiction on a permanent basis.

On February 17, 1989, Mojave and Texaco announced agreement on a contract for 185 MMcf/day of firm capacity on Mojave for a minimum 15 year term, with an option for an additional 50 Mmcf/day of interruptable transport capacity. This is Mojave's first major customer commitment and is an important indication that the EOR market is not uniformly intent on direct access to Wyoming supplies.

Kern River has, as indicated above, signed an agreement with SoCalGas which would cause an amendment of its Section 7(c) certificate application at the FERC in order to conform to the anti-bypass and jurisdictional requirements of I.88-12-027. Prior to this agreement, Kern River stood in the same position as Mojave in that a decision on its application was pending at the FERC, but Kern had taken no steps to bring its project into conformity with the goals of this Commission. The agreement with SoCalGas represents very significant progress to the extent that a major pipeline proponent, and, by implication, the EOR producers which support that pipeline, have agreed to terms which

significantly reduce the negative impacts of bypass for California ratepayers and preserve California's jurisdiction over its crucial gas distribution facilities. Such a step was essential to begin a move toward a comprehensive settlement which addresses the needs of the EOR and non-EOR markets while meeting the Commission's criteria for new capacity. It should be pointed out that the agreement does not actually commit either SoCalGas nor Kern River to contract for capacity on each other's proposed facilities. It really represents an agreement to compete for the remaining EOR and non-EOR load. That is, in fact, exactly what can be anticipated from this agreement--many more intense discussions with customers by both SoCalGas and Kern River.

Wyoming California Pipeline Company (WyCal) has been granted an Optional Certificate by the FERC, including the issuance of an order on environmental issues which removes the last condition from WyCal's initial certificate. Thus WyCal is the only pipeline with an effective certificate in hand, although to date, WyCal has announced neither successful financing of its project nor the commitment of any customers for firm capacity. Importantly, WyCal has not committed to any of the structural or jurisdictional changes to its project which would be required to conform to the criteria set forth in I.88-12-027.

Southcoast Transmission Company has, to our knowledge, not filed its application with the FERC, and has no commitments from major customers. The Southcoast project, as represented by its proponents, would not satisfy the criteria in I.88-12-027 on either bypass or jurisdictional grounds.

Mexus Pipeline Company has not perfected its application at the FERC, according to the information available to us at this time, and has no major customer commitments. Neither does Mexus, as proposed, contain restrictions which satisfy the key bypass and jurisdictional requirements of I. 88-12-027.

The APEX project for a Canadian producer-built PGT expansion has not filed any application, and the Commission is

uncertain if it intends to file a separate application or proceed on the basis of PGT's own application. While the position of APEX on the criteria in I.88-12-027 is not clear at this point, so long as the ultimate project resembles that planned by PGT, it could meet the standards set forth by the Commission. Equity ownership by out-of-state producers does not necessarily infringe any of the criteria in I. 88-12-027.

Altamont Gas Transportation Project has changed its proposal to encompass a direct route from Alberta to Southern California. As modified, the project would not meet the criteria set forth in I.88-12-027 without substantial changes, particularly with regards to bypass and jurisdiction within the state. Altamont does not appear to have any customer commitments at this time.

## 2. Expansions of Existing Pipelines

Pacific Gas Transmission Co. and PG&E have made a combined proposal to expand incrementally their existing facilities linking California with Canada to obtain an additional 600 MMcf/day of capacity. A FERC application has been filed, and a notice of intent to file a certificate application before this Commission has been received. PGT's project, which would be FERC jurisdictional only outside of California and utilize PG&E's regulated facilities within California, is structurally and jurisdictionally consistent with I.88-12-027. PGT has also filed letters of intent from a large number of potential customers, totaling 590 MMcf/day, including Edison and SDG&E.

El Paso Natural Gas Company and Transwestern Pipeline Company have separate certificate applications pending before the FERC to expand their respective systems, originally for the purpose of supplying gas to the Mojave project. These applications are ripe for decision at the FERC now that hearings have concluded. Neither pipeline expansion involves construction within California, therefore, neither is by itself a bypass

pipeline. If combined with a jurisdictionally appropriate project within California, El Paso and Transwestern could participate in a project which meets the criteria of I.88-12-027, although modification of their original applications would likely be required. Neither pipeline has signed agreements with any major customers at this time, although the agreement between Texaco and Mojave virtually ensures that either or both pipelines will seriously discuss such an agreement with Texaco.

SoCal has proposed an incremental expansion of its own transmission facilities to provide an additional 400 MMcf/day of capacity for \$100 million. This expansion, if married to an incremental increase in El Paso or Transwestern capacity would meet the key bypass and jurisdictional criteria of I. 88-12-027 as all transmission and distribution within California would take place on regulated utility facilities. SoCal has not announced customers committed to this project, but has obtained commitments to contract for firm capacity which could be satisfied by this expansion. See discussion below.

PG&E has proposed two alternatives for service between Kern County and the Arizona border: an expansion of its own Line 300, and a stand alone facility paralleling Line 300. Either project could be structured to be temporarily federal in jurisdiction to meet the wishes of EOR producers. So long as jurisdiction was certain to be returned to the CPUC, after a fixed period, and commitments against non-EOR bypass were obtained, these projects could meet the criteria set out in I. 88-12-027. PG&E has not announced any agreements with customers for this capacity.

### 3. Agreements for Greater Access to Firm Capacity

SoCalGas has actively sought to contract with its UEG and industrial customers to assign firm capacity rights on the interstate pipelines with which it has service agreements. The City of Long Beach and SDG&E have executed letters of intent for

such an assignment. As such measures do not involve bypass and retain CPUC jurisdiction over intrastate facilities, they clearly meet the key criteria of I.88-12-027. The Commission has the obligation to study the varying proposals of the utilities for capacity assignment, and SoCalGas' proposals must undergo that scrutiny in I.88-08-018. However, agreements to restructure existing capacity in more efficient ways such as those just reached by SoCal were clearly contemplated by I.88-12-027, and represent significant progress in resolving the need for a higher level of service without costly new pipeline construction. While the details of the agreements remain to be evaluated, such agreements must be considered as viable alternatives to the construction of new capacity.

#### 4. Summary

Five projects clearly have the potential to satisfy the Commission's stated criteria for pipeline capacity: PGT/PG&E, Kern River, SoCalGas' incremental expansion, either version of PG&E's incremental expansion, and SoCalGas' capacity assignment program. The SoCalGas expansion project and the two PG&E projects involving facilities from Kern County to Arizona could also include expansions by either El Paso or Transwestern. This is an encouraging result, given the months of stalemate and unproductive litigation which have characterized the quest for new capacity so far. It must also be emphasized that with the execution of amended applications and agreements similar to that signed by Kern River other pipeline projects could become viable in the eyes of the Commission. It is the intent of this decision to ensure that all project proponents who wish to receive equal consideration clearly understand the need to conform to the criteria set out in I.88-12-027. If more projects meet the prerequisites of that decision, then the customers who desire more pipeline capacity will have a greater selection of projects to choose from.

We fully anticipate that our decision will provoke further negotiation between many of the project sponsors and the utilities. All projects which meet the criteria set out in I.88-12-027 as reflected by an agreement executed within 60 days will receive equal consideration. However, projects which wait until our decision making process has advanced significantly may forfeit opportunities to participate in a comprehensive settlement of the capacity issue.

#### B. Level of Service Issues

As indicated above, the Joint Utility Response lists as its first conclusion the fact that there is "a need for greater access to firm capacity rights given current and foreseeable conditions under the newly emerged gas industry structure." (Joint Response, p. 2.) This need is merely symptomatic of a trend which has been steadily developing since the FERC and this Commission first began to restructure the gas industry. In I.88-12-027 we raised the question of whether a gas industry organized along the lines of a competitive market, with unbundled services and open access transportation, could function as efficiently for all customers as the traditional monopoly model industry. With respect to the specific issue of adequate transportation service for non-core customers, the answer appears to be no.

We note that those respondent utilities which are customers of the gas distribution utilities (Edison, SDG&E, and by virtue of its own electric department, PG&E) are all on record as believing that additional pipeline capacity is required at present. They further indicate various degrees of willingness to participate in the construction of such facilities and to sign contracts for firm capacity. Similar comments have been made to the Commission by other parties in recent proceedings on curtailments. For example, at the en banc on long term gas supply issues held in I.88-08-052 statements supporting the need for new capacity were made by, among others, the Southern

California Utility Power Pool (Reporters Transcript, Oct. 3, 1988, vol. 1, p. 10.), the City of Long Beach (R.T., p. 17.), the California Cogeneration Council (R.T., p. 66.), the California Industrial Group (R.T., p. 74.), Mock Resources (R.T., p. 74.), and Chevron U.S.A. (R.T., p. 108.). The presence of potential customers ready and willing to pay for new capacity is perhaps the clearest indication that the market requires new capacity to function as efficiently as it might.

However, other independent measures of the efficiency of the current system support the same conclusion. Taking into account the recent weather-related curtailments of industrial and electric generation customers in both Northern and Southern California, non-core customers have experienced three significant curtailments within the last 15 months, including curtailments during two of the three winters since open access transportation commenced. See I. 88-02-013 (curtailment of the winter of 1987-88); I. 88-08-052 (curtailment of August-September 1988 and curtailment of February 1989.). We take official notice of the record in these proceedings as part of our consideration of the question of pipeline capacity.

While we remain convinced that curtailment of customers with alternative fuel capabilities is a justifiable and reasonable tool for gas distribution utilities to use to balance gas supply and demand, we are not content to suffer curtailments on a routine basis. As we discussed in I.88-12-027, there are factors which will increase the importance of sufficient access to gas in the California energy markets of the future, such as air quality restrictions on the use of fuel oil for industrial purposes.

The number of such curtailments experienced in the last fifteen months may be an indication that structural changes in the market are needed. The last time California experienced sustained and recurring curtailments was during the gas shortages of the 1970's. Those curtailments were a reflection of a serious nationwide imbalance in the market which restricted the

exploration and development of new gas supplies for the interstate market. The response of Congress was to make sweeping changes in the regulation of the industry by passing the Natural Gas Policy Act of 1978. The recent curtailments do not appear to have been caused by pervasive shortages on a nationwide level, nor have they been as lengthy or as frequent as the curtailments of the 1970's. However, we have been presented with evidence which indicates that the curtailments may be the result of a number of coincident factors, including spot gas non-performance, management of storage, and insufficient pipeline capacity to meet extreme peak gas demands. See, for example, Report of the Division of Ratepayer Advocates on the Reasonableness of Gas Supply Operations and Financial Audit of Southern California Gas Company 1987-88, filed November 1, 1988, I.88-02-013, pp. 3-1 to 3-15. Similarly, we have seen brief curtailments which appear to begin with a gas supply shortage but which proceed to cause subsequent interruptions of non-core service as all available capacity is used to obtain sufficient supplies to meet high priority customer demand. See Emergency Motion by Southern California Gas Company for Declaration of Gas Supply Emergency in R.86-06-006, filed February 8, 1989. Irrespective of whether the initial cause of the curtailment is supply or capacity related, non-core transportation capacity and reliability have eventually been negatively impacted.

The frequency of curtailments since the initiation of open access transportation, the comments of numerous end-users and shippers supporting the need for new capacity, the demand for greater access to firm capacity rights, and finally, the existence of utilities willing to construct and pay for new capacity lead us to conclude that a higher level of service reliability for non-core customers is warranted. Along with more efficient utilization of existing pipeline capacity, new pipeline capacity appears to be an appropriate means to provide such a higher level of service. New capacity would enhance the level of



service provided to non-core transmission customers, who have been adversely affected by all three recent curtailments.

However, new capacity may also indirectly improve non-core customer procurement options by increasing the number of pipeline routes for moving gas to California, and by driving gas prices lower through enhanced gas-to-gas competition. Additional capacity provides purchasers with an increased ability to switch their purchases from one producing area to another in pursuit of the lowest prices. When pipeline capacity is constrained, customers may be forced to use capacity, and thus to buy from less competitive suppliers, simply to ensure that they receive enough supplies to meet their total demand. Edison has provided an example of this phenomenon with its comparison of the SoCalGas and PG&E portfolio costs contrasted with the varying load factors on the pipelines supplying their systems. Edison has presented a calculation which indicates that the construction cost of a 10% increase in the existing pipeline capacity serving the state could be offset on an annual basis by a 3% decrease in the cost of all gas delivered to Southern California. Edison further indicates that it believes a 3% reduction in gas costs is reasonable given the experience of PG&E in lowering gas costs in 1987, during which year PG&E experienced a load factor approximately 20% lower than SoCalGas. See Response of Southern California Edison Company to Order Requiring Proposals for New Pipeline Capacity, filed Feb. 1, 1989, pp. 15-16.

While all these factors have led us to conclude that a higher level of service would be more reasonable, we do not at this time select any given level of service or any specific quantity of pipeline capacity which ought to be added. We charge the respondent utilities with examining the market for new capacity and developing proposals for sufficient capacity allocation or new capacity construction to provide a higher level of service for the non-core market which is economically justifiable. The demands of the utilities' customers will obviously be critical in making this determination, and that is

why the Commission remains committed to encouraging the market to reflect its real demand through the execution of agreements for capacity assignment or for the construction of new capacity.

Prior to making a final determination of the appropriate project or projects to provide enhanced levels of service for non-core customers, we see no justification for altering our litigation position with respect to any of the certificate cases at the FERC, nor for withdrawing any of the appeals we have taken from the administrative process to date. As we have stated previously, our aim is to bring a comprehensive settlement to the FERC for federal certification, but until we reach a final decision on a policy for capacity expansion, it is not possible to know which, if any, of the projects before the FERC should go forward. In addition, we note that, as filed, none of the projects seeking certification at the FERC, with the exception of PGT and possibly an amended Kern River project, meet the criteria we set forth in I. 88-12-027. Clearly our support for any project will hinge on its ability to attract customers in California and its ability to conform to our requirements, including such standards as economic justification, guarantees against bypass, and assurance of appropriate jurisdictional structures. Accordingly, we leave for future consideration any alteration of our position in the pending certificate litigation.

### C. Excess Capacity and Stranded Investment

We noted in I.88-12-027 that the issue of new pipeline capacity raised questions of excess capacity, given that annual gas demand in the state is still well below the historical peak levels served in previous years with the existing interstate pipeline network. (I.88-12-027, p. 10.) Furthermore, the notion of "swing capacity" to enhance gas-to-gas competition implies that some capacity will remain unused most of the time, in order to preserve a range of options for purchasers. We have been urged by the respondent utilities to bear in mind that the

benefits of operating flexibility, supply diversity, and gas-to-gas price competition can outweigh the unit cost benefits of high load factor usage of pipeline capacity. (Joint Response, p. 3.) Their point, if supported by the facts, is well taken. It remains to be demonstrated that any given incremental addition of pipeline capacity will provide greater benefits through flexibility and price competition than the cost of those facilities. However, the Commission is receptive to utility justification of such proposals. I.88-12-027 specified that all new capacity additions must be proved to be economically justifiable to enhance supply or transportation reliability, promote price competition, or to serve incremental demand. Clearly, such a showing may support the notion that some facilities will be operated at less than the high load factors experienced in recent years.

This also applies to the concept of stranded investment, which relates to existing facilities which are underutilized as a result of load shifted to new facilities. So long as reasonably anticipated savings from gas-to-gas competition or the financial benefits of higher reliability can offset the fixed costs of such underutilized facilities, it is beneficial to build the extra capacity.<sup>2</sup> We will simply require a showing of economic justification for new projects which addresses this issue. We are mindful that precise calculation of future benefits is problematic, but we believe that the utilities, particularly Edison, have demonstrated that the potential benefits of additional capacity can be evaluated intelligently.

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2. Variable costs will continue to be borne only to the extent that the capacity is utilized, although over successive rate cases before the FERC, there exists a risk that a pipeline would seek to shift costs previously assigned to volumetric rates to the unavoidable fixed portion of a modified fixed variable tariff.

#### IV. PROCEDURAL ISSUES

The question most frequently directed to the Commission since February 1 has been, "What is the next step?" The answer is that the months and months of deliberation and negotiation among pipeline proponents, utilities, end-users, and producers must finally come to fruition. As indicated in our review of the proposals before us, there are several pipeline capacity enhancements and several new pipeline projects which, on their face, meet the criteria we set forth in I.88-12-027. In addition, there have been concrete proposals for the assignment of firm capacity rights which will also serve to meet the needs of the market for pipeline capacity. We note that PG&E and SoCalGas have recently filed plans for capacity assignment or allocation in our continuing procurement case (I.88-08-018) pursuant to our Decision 88-12-099 and we are committed to proceeding with our efforts to make capacity allocation more responsive to the needs of the market. We feel that the criteria set forth in I.88-12-027, combined with the judgments reached in this Interim Opinion regarding an enhanced level of service for the non-core market and the role of excess capacity, provide sufficient guidance and direction for the parties to reach agreement on one or more proposals to meet the needs of the California market.

We specifically direct the respondent utilities, less Southwest Gas Corporation<sup>3</sup>, to continue to meet jointly or

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3. Southwest Gas Corporation stated in its Feb. 1, 1989 filing that its interests in the State of California are of such a small scale that it has not made a determination regarding the need for new capacity within California, nor has it endorsed any specific proposal. Accordingly, while Southwest is still invited to participate, the Commission shall not require Southwest to file a response in this phase of the proceeding.

individually with pipelines, end-users, producers, and each other to reach actual agreements for the provision of a higher level of service to non-core customers, either by means of new or expanded pipeline capacity, or capacity assignments, or a combination of both. We direct the four respondent utilities to file their agreement or agreements with us no later than 60 days from today. We emphasize that because of the intense scrutiny given to all the proposals, and the progress attained in conforming a number of the proposals to our criteria for acceptance, we expect the utilities to produce binding agreements and contracts for new service for the construction of new facilities.

We wish to make it clear that all interested parties, whether pipelines, end-users, producers, or other utilities are invited to join in the submission of proposals to the Commission which comply with the criteria of I. 88-12-027, either individually or jointly. We anticipate that once the utilities succeed in reaching agreement with one or more pipeline project sponsors, they will solicit support for the project from virtually all interested parties, including the DRA. By this order we also direct the respondent utilities to advise DRA at once of any new agreements for capacity assignment or addition. Similarly, we direct DRA to be an active participant in the proceedings from this point forward, and to commence a detailed analysis of all projects which meet the criteria of I. 88-12-027. This analysis, combined with DRA's own recommendations for the provision of a higher level of service for the non-core market shall be presented to the Commission within 60 days, with the understanding that the Commission may request further analyses if new proposals are submitted during this 60 day period.

At the end of this 60 day period the Commission will review the utility filings and those of the DRA and any other interested parties. If one or more viable settlement proposals are presented, the presiding Administrative Law Judge shall convene a settlement conference and implement our procedures for reviewing and obtaining comments on the proposed settlements.

If, however, in the sole judgment of the Commission, no settlement proposals have been submitted which can form the basis for a comprehensive settlement, the Commission will direct the presiding Administrative Law Judge to convene a prehearing conference and to set in motion an expedited hearing schedule to select the appropriate project or projects to deliver an enhanced level of service to the non-core market. We repeat our previous admonition that we will not tolerate extended or unreasonable delays in such a proceeding for discovery or for further negotiations. We believe that the utilities and the proponents of the various projects can present their positions in this case in far less time than is required for a full scale certificate proceeding. Accordingly, we will direct the Administrative Law Judge to set a schedule which will permit us to issue a final decision in this proceeding no later than our regularly scheduled meeting on August 3, 1989.

We have no doubt that settlement represents a far more efficient means to resolve the issues before us, but we are prepared to conduct the hearings as expeditiously as is necessary to develop a policy to enhance the level of non-core service. Furthermore, we expect such hearings to be concluded in time to permit the results of such proceedings to be presented to the FERC for timely consideration in their certificate proceedings.

If no settlement is reached, all parties are placed on notice that the scope of the hearings will require the utilities to present testimony on the level of enhanced service which should be provided to the non-core market, the optimal means of achieving such an enhancement, and an analysis of all the alternatives considered by the utilities during these proceedings. Any project advanced by one of the utilities must be supported by an analysis to indicate compliance with the criteria spelled out in I.88-12-027.

## V. CONCLUSION

It is the Commission's intent to reach a decision in this case which spells out a long term policy for the State of California on the need for pipeline capacity to provide an adequate level of service to all customers. We intend to utilize the operation of the market for new capacity to help us fashion a coalition of regulators, utilities, end-users, producers, pipelines, and other parties to support FERC certification of a project or projects which will implement that policy. We intend for the California market to have the maximum impact in the regulatory decisionmaking process as it is the California market which is the target of the recent proliferation of interstate and intrastate pipeline proposals. We are firm in our belief that the utilities and end-users in California will jointly adopt an efficient means of enhancing the level of natural gas service within the state when challenged to commit their own resources for the construction or assignment of the needed capacity.

## FINDINGS OF FACT

1. The Commission has commenced a radical restructuring of the natural gas industry within the state, similar to and designed to operate in conjunction with the federal restructuring of the interstate gas markets.

2. This restructuring has begun to disclose unforeseen problems and the need for adjustments in the policies of the Commission.

3. While there is little evidence to support the need for additional pipeline capacity based upon total statewide average annual demand, it appears that the capacity of the interstate and intrastate pipeline systems serving California are insufficient to prevent periodic peak season curtailments of low priority customers' transportation rights.

4. There is also evidence to support the conclusion that non-core customers are unable to obtain firm transportation capacity.

5. There is also evidence that in Southern California, there is insufficient interstate pipeline capacity access to permit the full benefits of gas to gas price competition to reach non-core customers.

6. The unbundling of the interstate and intrastate pipeline systems has caused a proliferation of buyers and sellers of gas, all seeking transportation capacity on a daily basis, thereby causing the system to operate at a lower level of transmission efficiency than when interstate pipelines provided 100% of the gas purchasing, aggregating and transporting functions.

7. California has experienced three curtailments of non-core gas service within the last fifteen months, including two of the three winters since open access interstate transportation first became available to California.

8. Each of these three curtailment incidents, whether supply or capacity related, produced a significant negative impact on non-core transportation service.

9. Recurring occasional peak season curtailments of non-core transportation service will continue to occur absent any change in the level of service provided by the utilities.

10. Frequent curtailment of non-core transportation service undermines confidence in the market for gas transportation services, disrupts industrial operations, and reduces the benefits of a competitive interstate gas market available to California industry.

11. Curtailment of low priority customers remains an essential mechanism for balancing supply and demand, although curtailments are to be avoided if reasonably possible.

12. Each of the major electric utilities which purchases gas from a gas utility supports the addition of new pipeline capacity and indicates a willingness to pay for such capacity.



13. A substantial number of interested parties have advised this Commission of their belief that new interstate pipeline capacity is needed for California.

14. The benefits of the competitive interstate gas market include an efficient allocation of gas supplies, access to a greater diversity of gas supplies, and lower costs of gas through gas to gas price competition.

15. A comparison of Northern and Southern California average gas costs and pipeline load factors reveals that added pipeline capacity may be a factor in producing lower gas costs through gas to gas competition.

16. There is a need for greater access to firm capacity rights on either existing or new pipelines.

17. New interstate and intrastate pipeline capacity may provide the appropriate means to enhance the level of service for non-core customers.

18. Assignments of capacity or some form of brokering of firm capacity may also provide an enhanced level of non-core service and should be considered as alternatives to new pipeline capacity.

19. It is not possible to calculate precisely the needed level of service for the non-core in terms of an increment of capacity stated as a specific number of million cubic feet per day with the information currently before the Commission.

20. The market demand for new capacity as expressed by utilities and end-users willing to contract for new capacity or firm capacity rights should define the higher level of service needed for the non-core.

21. In order to define the existing market for new pipeline capacity it is necessary to evaluate actual agreements between pipeline project sponsors and utilities or end users.

22. Several projects have been proposed to date which on their face meet the criteria set forth by the Commission in I.88-12-027 for new pipeline capacity.

23. At the present time the Commission cannot make a finding that, as filed, any of the pipeline projects which have or are about to receive certificates from the FERC are required by the public interest or comply with the Commission's criteria in I.88-12-027.

24. Adding pipeline capacity increases the risk of underutilizing new or existing pipeline capacity, but such risks may be offset by operational flexibility, diversity of supply access, or the benefits of gas to gas competition.

25. The federal process for certificating new interstate pipelines to California has progressed to a point where the Commission must act decisively and rapidly for any newly developed state policy to be implemented in time for it to be presented to the FERC as part of the Commission's comments on any pipeline's settlement proposals.

26. If no settlement is reached satisfactory to the Commission within 60 days, the need to define a policy for pipeline additions would require the commencement of expedited hearings on the appropriate means to provide an enhanced level of service to the non-core which would permit the Commission to consider a final decision in this proceeding no later than August 3, 1989.

27. Parties well familiar with their own needs for firm capacity or capacity rights and with the various proposals for new pipeline capacity could prepare to state their positions in a comparative hearing without lengthy delays.

#### CONCLUSIONS OF LAW

1. The Commission has the statutory responsibility to approve the addition of new pipeline capacity to serve the California utility market under Sections 451, 761, 762 and 2771 et seq. of the Public Utilities Code as part of its responsibility to ensure that adequate utility service is provided at just and reasonable rates; that the service and

facilities of the utilities are sufficient and reasonable, and to determine the level of service to be provided to all classes of customers.

2. The Commission has the authority to regulate the local distribution of natural gas within California granted to the states by the Natural Gas Act of 1938.

3. A higher level of service ensuring greater reliability for non-core transportation service is warranted in order to compensate for changes in the gas markets caused by the recent revision of regulatory structures to increase competition in the industry.

4. Any pipeline project to be considered by the Commission as a means to enhance the level of service for the non-core market must comply with the criteria set forth by the Commission in I.88-12-027.

5. Until the Commission is in a position to determine which, if any, new pipeline projects are required to provide an enhanced level of service for the non-core market, or which of the projects comply with the Commission's stated criteria in I.88-12-027, it is not appropriate for the Commission to alter its litigation position in the pipeline certificate cases currently pending before the FERC.

6. Southwest Gas Corporation, owing to its relatively small interests within the state, should be relieved of the obligations of a respondent in this proceeding, although it remains free to participate if it so desires.

ORDER

Therefore,

IT IS ORDERED that:

1. The respondent utilities are directed to meet jointly or individually with pipeline project sponsors listed in Attachment A to I.88-12-027, and with any other end-users or other parties which the respondent utilities desire to include in their discussions, to reach agreements to implement capacity assignments or to construct new pipeline capacity to provide an enhanced level of transportation service for the non-core market which can be economically justified.

2. The respondent utilities shall report back to the Commission on their efforts, jointly or individually, and file an original and twelve copies of their reports with the Docket Office along with any actual agreements reached to assign or construct capacity within 60 days. In addition, the utilities shall serve their responses on all parties in I.88-08-052 and R.88-08-018.

3. All interested parties may join in submitting proposals to assign or construct capacity to the Commission so long as they comply with the criteria set forth in I.88-12-027.

4. The respondent utilities shall immediately advise DRA of any new agreements to assign or construct capacity and provide DRA with copies of any agreements and such other information as is needed for DRA to evaluate such agreements.

5. DRA shall commence an analysis for presentation to the Commission of all proposed projects to construct or assign interstate or intrastate pipeline capacity to serve California which comply with the criteria set forth in I.88-12-027. DRA shall present its interim conclusions based on currently available information within 60 days and shall be prepared to conduct further analysis on such other proposals as may be presented to the Commission at that time.

This order is effective today.

Dated FEB 24 1989 at San Francisco, California.

G. MITCHELL WILK  
President  
FREDERICK R. DUDA  
STANLEY W. HULETT  
JOHN B. OHANIAN  
Commissioners

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

*Victor Weisner*  
Victor Weisner, Executive Director