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Decision 91-06-017 June 5, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Application of PACIFIC GAS AND ELECTRIC COMPANY for a Certificate of Public Convenience and Necessity to Construct and Operate an Expansion of its Existing Natural Gas Pipeline System. (U 39 G)	Application 89-04-033 (Petition for Modification filed February 13, 1991)

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OPINION

A. Summary

In Decision (D.) 90-12-119, the Commission granted the applicant, Pacific Gas and Electric Company (PG&E), a certificate of public convenience and necessity for the expansion of PG&E's gas transmission facilities (Expansion Project), subject to conditions. Several petitions for modification and applications for rehearing were subsequently filed.

This decision disposes of the rate design and cost allocation issues that were raised in those pleadings. The originally adopted full-fixed rate design is replaced with a modified-fixed variable rate design. Equity-related costs will be collected in a volumetric rate for firm transportation. The "pure incremental" cost allocation adopted in D.90-12-119 is replaced by "allocated incremental" cost allocation. The capital cost of the portion of existing facilities to be used by the Expansion Project, apportioned by a throughput factor, will be paid by the Expansion Project to existing ratepayers. The use of a single delivery rate based on a the cost of service for the entire Expansion Project is affirmed. No modification to D.90-12-119 is made to address rolled-in ratemaking or PG&E's use of precedent agreements.

B. Procedural Background

The "Petition for Modification and Clarification of the Division of Ratepayer Advocates" (DRA) was filed on February 13, 1991. The DRA requests the Commission to modify D.90-12-119 to conform the rate design and cost allocation policies adopted in that decision with the positions taken by the Commission at the Federal Energy Regulatory Commission (FERC). DRA also requests modification of the decision to disapprove of rolled-in ratemaking at the FERC and to deny PG&E the recovery of Expansion Project costs from existing ratepayers.

DRA seeks "clarification" of the Commission's views on PG&E's use of precedent agreements, the use of a postage stamp rate for Expansion transportation, and an acknowledgement that San Diego Gas and Electric Company (SDG&E) does have access to firm interstate capacity.

The "Application for Rehearing and Stay of Decision No. 90-12-119" filed on February 11, 1991 by Toward Utility Rate Normalization (TURN) asserts that the decision to allow Expansion shippers to use the existing PG&E pipeline facilities without paying any portion of existing costs is contrary to recent pronouncements of Commission policy.

"Kern River Gas Transmission Company's (Kern River's) Application for Rehearing of Decision 90-12-119" was filed on February 11, 1991. Kern River claims the Commission committed legal error in authorizing transportation to a single delivery point and a nonmileage based rate (postage stamp rate) and erred by failing to allocate a portion of the cost of existing facilities and the cost of existing gas department services to the Expansion.

The "Application of Altamont Gas Transmission Company (Altamont) for Rehearing of Decision 90-12-119" was also filed on February 11, 1991. Altamont claims that the adopted incremental rate design is inconsistent with prior Commission actions, that approval of the 100% reservation charge is inconsistent with the Commission's goals of promoting gas competition, and that approval of a postage stamp rate undercuts competition. Altamont objects to the Commission's conclusion that benefits from the Expansion Project will outweigh the impact of FERC's adoption of rolled-in ratemaking of the cost of the Pacific Gas Transmission Company (PGT) portion of the Expansion.

The Application of Amoco Canada Petroleum Company Ltd. (Amoco) for Rehearing of Decision 90-12-119 was filed on February 11, 1991. This intervenor claims that the adopted 100% reservation charge is contrary to the public interest and the approved incremental rated design is contrary to Commission policy.

The "Response of Pacific Gas and Electric Company to Applications for Rehearing and Modification" was filed on February 26, 1991. The project applicant asserts that none of the pleadings provide any reason why this Commission need reopen or modify its decision.

On February 26, 1991, "Southern California Edison's (Edison's) Response to Applications for Rehearing or Modification of Decision 90-12-119" was filed. Edison objected to the assignment of common costs to the Expansion Project on grounds similar to those asserted by PG&E. In addition, Edison fears that the resultant rates would place the Expansion Project at a competitive disadvantage.

The claims of TURN, Kern River, and Altamont, and Amoco which have been identified above fall short of asserting legal error. They should be disposed of in this decision on modification since they were also raised in DRA's petition for modification.

C. Issues

1. Rate Design

In D.90-12-119, the Commission established a one-part rate for the Expansion Project. Ninety-three percent of the Expansion's annual revenue requirement was to be collected through a fixed monthly demand charge on firm transportation customers. The remaining seven percent of the revenue requirement was to be collected through the rate for interruptible transportation. No volumetric rate was assessed on firm transportation. This was described as "full-fixed variable rate design."[1]

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1 Although the Commission adopted PG&E's label for this rate design, a more accurate term would be "full fixed". The term "full-fixed variable" is employed by the FERC to describe a rate design wherein a demand charge is assessed to collect fixed costs and return on equity. The demand charge excludes operational costs which vary with throughput; costs which vary with throughput are then collected in volumetric rates. The Expansion Project would have no volumetric rate, so its rate design was actually "full fixed."

DRA and Altamont ask us to consider the rate design adopted for the Expansion Project in the context of prior decisions on gas pipeline rate design. The Commission has previously distinguished its treatment of the utility's return on equity and associated taxes (equity-related fixed costs) from the means of recovery authorized for the other components of gas transportation revenue requirement.

In the decision resulting from our investigation into implementing a rate design for unbundled gas utility services, this Commission designed transportation rates whereby equity-related fixed costs were allocated based upon the capital expense of transmission facilities; these expenses were allocated to various customer classes based on their throughput over the utility's transmission facilities. (D.86-12-009.)

In D.87-12-039, the Commission subsequently examined the appropriate level of risk assigned to the gas utilities through the default rate for intrastate transportation.[2] The Commission adopted the principle that there should be "demand charge treatment for costs that are fixed and beyond the utility's control, volumetric treatment for those over which the company has influence." (26 CPUC 2d 213,275.) The Commission has recently affirmed that the cost of return on preferred equity is to be recovered in the volumetric rate (D.90-01-015) and that franchise fees and uncollectibles should also be recovered in volumetric rates (D.90-11-023).

The Commission recognized that if the default rates removed virtually all risk from the utility, then the utility would be unlikely to negotiate with customers concerning the structure

2 The default rate applies to transportation service when the utility and the customer are unable to reach a negotiated agreement.

and level of rates. "The risk transferred to utilities from customers by the adopted volumetric rate can be shared with upstream pipelines and producers." (D. 87-12-039, Finding of Fact 79.)

As authorized by D.90-12-119, the Expansion Project rate design collects no portion of the firm transportation revenue requirement through volumetric rates. It is incompatible with the Commission's unbundled intrastate gas transportation rate structure.

The Commission's position on interstate gas transportation rate design was most recently presented in the "Comments of the Public Utilities Commission of the State of California on Rate Design Policy Issues", filed in FERC Docket No. PL89-2-005 (Interstate Natural Gas Pipeline Rate Design) (Comments of CPUC).

The rate design principles which we have advocated to the FERC are equally sound in the context of intrastate natural gas transportation. They may be summarized as follows: Costs allocated to and recovered in demand charges or reservation charges of firm transportation customers are treated by the industry as sunk costs. Once the pipelines have executed long-term service agreements, their firm transportation customers must pay these charges so long as the regulatory body has approved the pipelines' rates. Pipelines may attract shippers by offering competitive volumetric charges.

To the extent that a pipeline's volumetric charges are too high in view of competition, the pipeline can discount its rates to be competitive. The efficient pipeline is rewarded by fully earning its authorized return and recovering all of its fixed costs due to the high throughput level it is able to achieve. This is superior to demand charge recovery of the entire cost of service where the pipeline need not worry about its sunk costs and has no incentive to control costs in order to compete.

In D.90-12-119, we distinguished our position at the FERC from our decision to adopt a full-fixed rate design. We reasoned that the operations of PGT being reviewed at the FERC were those of a merchant of natural gas while the proposed operations of its parent, PG&E, would be those of a transporter of natural gas. Nonetheless, we find it appropriate to amend the rate design for the Expansion Project in order to promote increased price competition between gas producers.

While the role of pipelines and local distribution companies as merchants of natural gas is declining because of the unbundling of the transportation function in the gas industry, we believe that the impact of pipelines on gas prices should not be underestimated. Other things being equal, lower demand and reservation charges will tend to increase the ability of shippers to obtain gas economically from different producing regions and will tend to increase interregional competition among producers. In addition, by increasing the percentage of pipeline costs allocated to volumetric rates, the desire of the pipeline to maintain low volumetric charges can be harnessed to reduce the overall cost of gas transportation. With lower transportation costs, a pipeline should be able to develop a broader market of potential gas suppliers. The end result should be greater diversity of supply and lower prices to California consumers.

The Expansion Project is intended to provide intrastate transportation just as existing PG&E facilities provide unbundled intrastate gas transportation. We would prefer to adopt a modified-fixed variable rate design for the Expansion Project consistent with the principles announced in D.87-12-039 and applied in D.90-01-015 and D.90-11-023. A volumetric rate would be assessed for firm transportation on the Expansion Project. Such a modification would make our rate design for the Expansion Project consistent with previous Commission decisions on intrastate transportation rate design and with positions we have expressed to the FERC.

In its Preliminary Determination of Non-Environmental Issues for PGT's portion of the Expansion (Preliminary Determination), the FERC allocated 51% of equity-related costs to PGT's volumetric rate. FERC's final determination of the percentage will be based on the outcome in PG&T's pending general rate case. There, the Commission had recommended that 100% of the Expansion's interstate equity-related costs be recovered through its volumetric rate. Consistent with our recommendation to the FERC, we will require 100% of the equity related costs to be collected through the Expansion Project's volumetric rate.

We prefer a rate design for firm transportation service consisting of a two-part rate calculated to recover 93% of the project's annual revenue requirement. The volumetric rate should be computed to recover revenue requirement associated with the following cost items:

a. 100% of return on equity and associated taxes.
b. Shrinkage and fuel use.
c. Franchise fees and uncollectibles.[3]

The demand charge should be set residually to collect the remainder of the firm transportation annual revenue requirement. The rate design adopted by D.90-12-119 for interruptible transportation need not be revised.

The foregoing describes our preferred rate design for the Expansion Project. We recognize, however, that the Expansion Project must compete against other interstate pipelines to serve

3 Although the CPUC fee is collected as part of the default volumetric rate for intrastate transportation, the CPUC fee associated with the Expansion should be collected from the volumetric interruptible transportation rate as originally proposed by PG&E.

California[4], and as a consequence we grant the project proponent and shippers leeway to negotiate other transportation rates that may better serve their needs. The Commission's preferred rate design would be used in the absence of any negotiated rate design. Regardless of the methodology chosen by the sponsor and the shippers, PG&E is required to present its proposed rate design for approval in the first Expansion general rate case.

Since the pipeline and its shippers may negotiate a rate design, those parties might attempt to minimize their risk by shifting liability for pipeline costs to PG&E's non-Expansion ratepayers. D.90-12-119 should be modified to specify that regardless of the adopted rate design or any other arguments on risk allocation that may be made at the Expansion Project's first general rate case or in subsequent proceedings, the Expansion Project's revenue requirement shall not be recoverable from PG&E's non-Expansion ratepayers.

2. Cost Allocation

Under the "pure incremental" allocation methodology adopted by D.90-12-119, all costs of the Expansion would be borne by Expansion shippers. They would not pay any of the costs of the existing system even though the Expansion must use portions of the system. Conversely, all of the costs of the existing system will continue to be borne by existing ratepayers; they will not pay for any of the costs of the Expansion even though the Expansion provides some operational benefits to them.

In the PGT general rate case pending before the FERC, the Commission advocated an "allocated incremental" cost allocation of

4 Since administrative and general (A&G) costs are not recovered in the commodity charge of FERC-tariffed interstate pipelines, we will similarly exclude all A&G costs from the volumetric part of the Expansion's default rate.

costs to PITCO, on whose behalf "added facilities" had been constructed.

Under this methodology, existing ratepayers bear the cost of original facilities and incremental ratepayers pay the cost of added facilities. However, the cost of the portion of the original facility to be used by customers of the added facilities is allocated between existing and incremental ratepayers based on their relative usage of the upgraded facility. As in the case of the Expansion Project, the existing pipeline was upgraded with additional facilities to accommodate the incremental user. The added facilities are not capable of providing service for PITCO in the absence of the original facilities.

In its petition for modification, DRA proposes to allocate to Expansion Shippers the capital cost of the portions of the existing system to be used by those shippers. DRA calculates the cost as the average of the net book value and replacement cost. In its testimony, Kern River had recommended that a portion of the depreciated cost of those facilities should be assigned based on the throughput of existing and incremental users.

We determine that the Expansion Project should pay a fee for the use of the existing facilities without which the Expansion Project could not operate. A portion of the net book value of the facilities to be used, based on the ratio of Expansion Project throughput to the total throughput over the augmented system, will be allocated to the Expansion. We choose the net book value, and not the average of net book value and replacement cost as suggested by the DRA, because the use of replacement cost would negate our determination that Expansion Shippers should realize the economies of scale inherent in maximizing the use of an existing pipeline. Replacement cost may be an appropriate factor under other circumstances.

Using the numbers introduced on the record by DRA, the capitalized net book value of the portions of lines 400 and 300 B to be used by Expansion Shippers is $4,516,888. We then calculate the percentage of total (original plus Expansion) volume represented by Expansion throughput. Assuming transportation capacity on the existing PG&E system from Malin to Kern River Station of 1,017 MMcf/d[5] and Expansion Capacity of 755 MMcf/d yields an allocation factor of roughly .43. The cost of original facilities allocated to the Expansion Project should be $1,942,261. This allocation increases capital expenditure for the Expansion from $736 million to $738 million.

Allocation of a portion of existing A&G and operation and maintenance (O&M) expense to the Expansion is not warranted. Altamont argues that those expenses would not be incurred but for the operation of the Expansion. This is wrong; existing A&G and O&M expenses are incurred to serve existing PG&E ratepayers. Incremental A&G and O&M expenses clearly have been assigned to the Expansion.

We modify D.90-12-119 to apply the allocated incremental cost allocation methodology to the Expansion Project. The annual revenue requirement should be increased by the amount necessary to recover the allocated cost of the existing facilities over 30 years. PG&E should demonstrate that its rates are sufficient to recover this cost and propose an accounting mechanism for crediting the ratepayers of the existing system with these annual revenues in the Expansion's first general rate case.

3. <u>Rolled-In Ratemaking</u>

Altamont asserts that by approving the Expansion Project, the Commission has endorsed rolled-in ratemaking at the FERC. DRA claims that rolled-in ratemaking at the FERC would produce adverse

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5 <u>See</u>, D.90-02-016; decision on the Commission's investigation into interstate natural gas pipeline supply and capacity, deliveries to PG&E Line 300 at Malin.

economic impacts on ratepayers; both parties challenge the Commission's finding that benefits associated with PG&E's expansion would offset this impact. No party has testified regarding the incremental cost impact on California ratepayers if PGT's expansion costs were rolled into PGT rates.

Our approval of the PG&E Expansion Project is based on the overall costs and benefits of the pipeline. In light of the record before this Commission, we have found that certification of the project will produce net benefits for California ratepayers. We have promoted a policy of incremental cost allocation in our own proceedings and at the FERC. Accordingly, we have rejected rolled-in pricing for jurisdictional pipelines. However, we should not predicate our CPCN decision on speculation whether FERC will employ rolled-in pricing for the interstate portion of the Expansion.

Moreover, we note that the FERC may apply its rolled-in ratemaking treatment to expansions of other interstate pipelines competing against the Expansion Project. Kern River will be expanded to accommodate additional capacity on behalf of Altamont; El Paso's proposed expansions are pending at the FERC.[6] California consumers cannot be shielded from rate increases due to FERC's rolled-in ratemaking by a simple denial of the Expansion CPCN. Substantial benefits to California consumers would be foregone if the Expansion were denied due to fear of rolled-in pricing. No modification to the decision is required due to the potential for rolled-in pricing at the FERC.

4. Single Transportation Rate

In its Preliminary Determination, FERC established the conditions under which it would issue a CPCN to PGT for the interstate portion of the project, pending final environmental review.

6 See, D.90-02-016 (35 CPUC 2d 196, 238).

Among other things, the FERC required PGT to offer to make deliveries at the interconnection between the PGT and PG&E pipelines at the Oregon-California border. DRA asks the Commission to clarify "whether or not this would change or impact the single delivery point at Kern River Station or the postage stamp rates adopted by...(D.90-12-119)."

First, we clarify that D.90-12-119 does not limit Expansion deliveries to a single delivery point. Expansion shippers may require PG&E to deliver gas at any point along the Expansion. There is, however, a single transportation rate based on the cost of service to Kern River Station. The FERC decision does not affect our decision approving a "postage stamp rate", or, in other words, a single rate for transportation on the Expansion Project.

The Commission's adoption of a transportation rate based on delivery to Kern River Station was challenged for its allegedly anti-competitive effects. According to Kern River, the rate is subsidized by northern California shippers whose gas does not traverse the length of the Expansion and should not be considered in setting the rate.

We have already determined that the interests of all ratepayers in this state would be served by allocating efficiencies of scale and scope to incremental users of natural gas in southern California. To the extent southern California shippers receive any benefits from shipments destined for northern California, we find that such benefits are supported by public policy promoting economic development of the state as a whole.

In the course of our investigation to unbundle gas rates, transportation rates were derived through a process of determining whether the expense was incurred to provide distribution, transmission, or storage. Those functionalized costs were then allocated to different customer groups based on their usage under certain conditions. (D.86-12-009.)

Here, the primary purpose of the Expansion Project is to provide firm transportation of natural gas to the southern California market. Eighty percent of the volumes subject to precedent agreements is destined for southern California. If the market for gas in southern California did not exist, the Expansion Project would not be built. Shippers wishing to deliver gas ultimately to northern California would have no means of bringing additional Canadian gas into the state. Thus, the rate paid by all ratepayers, regardless of where the gas is consumed, is based on the cost of facilities to serve the class of customers for which the Expansion is "functionalized".

New pipeline will be constructed over 432 of the 544 miles of the Expansion Project, or 80% of the expansion. New facilities will be built from Malin, Oregon to Panoche Meter Station, 432 miles to the south. Rates based on the cost of facilities needed to deliver gas to northern California would allow northern California shippers to use the Expansion while avoiding the full cost of facilities built to accomplish the primary function of the Expansion.

If incremental shippers are allowed to pay PG&E's tariffed rate for its existing facilities, they would avoid the tariff rate that collects the cost of the facilities constructed expressly for them.

The reasonableness of a postage stamp rate for use of the Expansion is supported by the fact that the Expansion Project gas will be delivered by displacement. Without the use of displacement, the capacity of the Expansion would be less than its 755 MMcf/d design capacity. The pipeline looping in northern California alone cannot deliver 755 MMcf/d. That capacity is made possible by Expansion looping at the southern end of PG&E's system. That extra capacity will enable southwest supplies currently flowing to northern California to be diverted to southern California. Only through the operation of the southern portion of the Expansion can the northern section of the Expansion accept Canadian gas.

The fact that the entire Expansion is used to deliver gas over only a portion of the Expansion's length renders a distance-based rate inappropriate in this case. Indeed, since there is no basis in the record for calculating the cost of transportation on a mileage basis, any rate other than the adopted postage stamp rate would be an arbitrary one.

The fact that the Commission has previously authorized distance-based rates for intrastate transportation does not control in this case. We have allocated Expansion costs on a modified incremental basis to insulate existing ratepayers from risk. Thus, the Expansion tariff rate must allow PG&E to recover all of the Expansion's cost of service, including the cost of service associated with facilities that will be constructed in southern California. Without those facilities, the Expansion cannot accomplish its function of providing California with access to Canadian gas.

5. Availability of Existing System Rate

Altamont cites the FERC's statement in its Preliminary Determination that the Expansion Project's single delivery point "may be an illegal tying arrangement between interstate and intrastate transportation" in its argument against the single delivery point at Kern River Station. Altamont has taken the FERC's statement out of context.

Altamont has raised the phantom "requirement of a single delivery point" as a red herring. While the postage stamp transportation rate is based on the cost of service to the southern terminus of the Expansion Project, Kern River Station, an Expansion shipper may have its gas delivered to any point along the Expansion. The intrastate tariff does not block Expansion shippers from competing with PG&E in its service territory.

D.90-12-119 explains in greater detail that approval of the Expansion facilitates greater access to the Canadian gas market. We expect that lower prices and more security of supply will result from this access. The Expansion can provide these benefits to incremental shippers while shielding existing ratepayers from the risk of pipeline overcapacity only if Expansion costs are allocated to the incremental shippers. This is accomplished through allocated incremental cost based-rates, as opposed to rolled-in pricing.

Under our allocated incremental cost-based ratemaking, the risk of overcapacity will be reflected in Expansion rates. However, once existing capacity is occupied by incremental shippers, existing ratepayers would have to purchase capacity on the Expansion for their needs. Thus, existing ratepayers would be saddled with the risk of overcapacity. This is the exact result we sought to avoid in D.90-12-119 by imposing incremental cost allocation and a separate Expansion rate base and general rate case as a condition of certificate approval.

If Expansion shippers utilize all of the brokered capacity on the existing PG&E facilities, they will force existing ratepayers to pay Expansion rates for their incremental capacity needs. The average rate paid by the two groups, Expansion shippers and existing ratepayers, for service over the two facilities would be roughly equal. The result would be rolled in pricing of Expansion facilities, the result we consciously avoided by requiring Expansion rates based on incremental cost allocation.

In the course of restructuring of the gas industry in California, we have decreased the utilities' responsibility to procure supplies and capacity for their non-core customers. Thrusting responsibility for the cost of incremental facilities upon existing ratepayers runs counter to our program. Allocated incremental cost-based rates are the only means of ensuring that PG&E's existing ratepayers are shielded from the risk of overcapacity represented by capacity additions such as the Expansion. Interstate Expansion shippers must pay rates for intrastate transportation based on allocated cost; the alternative would ultimately lead to rolled-in rates and the attendant risk to existing ratepayers.

The single delivery rate does not represent a tying arrangement between interstate and intrastate transportation. It does enable PG&E to recover the cost of providing transportation over the Expansion. A rate based on the actual cost of the Expansion service is a necessary corollary to our decision to establish allocated incremental cost-based rates for Expansion service.

Our decision to restrict PGT Expansion shippers to the PG&E Expansion is based on our ratemaking principles and the facts before us. We expect that the capacity needs of existing ratepayers will become more obvious by the time of the first Expansion general rate case. Therefore, the restriction of Expansion shippers is an interim measure that will be revisited in the first Expansion general rate case.

In D.90-12-119, we found that Expansion Project gas destined for northern California would be subject to two transportation charges, one charge for Expansion delivery and an additional charge for delivery over existing facilities to a point within PG&E's service territory. The additional charge would be assessed at PG&E's intrastate transportation tariff rate.

To the extent that circumstances later change and, as a result, a different allocation of intrastate transmission service costs is found to be more appropriate, D.90-12-119 would not stand in the way of such a development.

Parties who assert that PG&E would enjoy a competitive advantage over other shippers of gas destined for northern California assume that PG&E is authorized to use the Expansion Project to transport gas. These parties overlook the fact that in

D.90-12-119, we questioned the reasonableness of PG&E's subscription to firm capacity on the Expansion Project. It is premature to consider these arguments until the first Expansion general rate case. If PG&E retains its subscription on the pipeline, the effect of its transportation of gas from Kern River Station to its service territory on competition will be reviewed during the first general rate case.

We are sensitive to issues being considered by the FERC in the PGT Certificate proceeding and other FERC proceedings, such as the El Paso and Transwestern Capacity Brokering cases. We will continue to review our decisions in light of the FERC's evolving regulatory program and the attendant changing conditions.

6. PG&E's Use of Precedent Agreements

DRA and Kern River point out that the FERC's Preliminary Determination requires PGT to hold a new open season for the initial allocation of all Expansion capacity. According to Kern River, the Commission's reliance on the contracts as evidence of market interest is unwarranted. The DRA asks the Commission to consider whether, given the FERC's findings, PG&E's use of its Precedent Agreements was anticompetitive and discriminatory. It is not necessary to address DRA's question since the FERC has already required PG&E to conduct a new open season.

Market interest did not disappear when the FERC decided to require a new open season. The lack of a written document does not vitiate the parties' intent to contract. It is that intent, as shown by market circumstances and the substantial commitments that the parties had undertaken under the Precedent Agreements, on which we base our finding of continued market interest in the Expansion Project.

D. Motion of Southern California Utility Power Pool

On January 11, 1991, the "Motion for Leave to Refile Comments of the Southern California Utility Power Pool (SCUPP) Because of Nonconforming Certificate of Service" was filed. SCUPP had attempted to file its comments on the proposed decision of the administrative law judge on December 17, 1990. Its filing was rejected due to a faulty certificate of service. The Commission took action on the proposed decision on December 27, 1990. The comments of SCUPP were moot at the time the motion was filed. The motion is accordingly denied.

E. Conclusion

After thorough review of the issues raised in DRA's petition for modification and the related matters argued by TURN, Kern River, and Altamont in their applications for rehearing, we conclude that D.90-12-119 should be modified to adopt a modified fixed variable rate design whereby the equity-related costs and other expenses of the Expansion Project are collected in a volumetric rate for firm transportation. D.90-12-119 should also be modified to require allocated incremental cost allocation; that is, the Expansion Project shall pay PG&E ratepayers a portion of the capital cost of the existing facilities to be used by the Expansion, based on relative throughput. We also acknowledge that Resolution G-2921 does not affect SDG&E's continuing need for access to the Canadian natural gas market.

In all other respects, the DRA petition for modification is denied.

Findings of Fact

1. In its "Petition for Modification and Clarification of the Division of Ratepayer Advocates (DRA)" filed on February 13, 1991, the DRA requested the Commission to modify D.90-12-119 to accomplish the following:

a. to conform the rate design and cost allocation policies adopted in that decision with the policies the Commission has taken on these issues at the Federal Energy Regulatory Commission (FERC),

b. to disapprove of rolled-in ratemaking at the FERC,

c. to deny PG&E the recovery of Expansion Project costs from existing ratepayers,

d. to clarify its views of PG&E's use of precedent agreements,

e. to clarify its views on a single delivery point and a nonmileage based transportation rate (postage stamp rate), and

f. to acknowledge that San Diego Gas & Electric Company (SDG&E) does have access to firm interstate capacity.

2. Toward Utility Rate Normalization (TURN), Kern River Gas Transmission Company (Kern River), Altamont Gas Transmission Company (Altamont), and Amoco Canada Petroleum Company, Ltd. (Amoco) raised various challenges to the cost allocation, postage stamp rate, rate design, and rolled-in rate determinations of D.90-12-119 in their applications for rehearing of D.90-12-119.

3. Pacific Gas and Electric Company (PG&E), the applicant for a certificate of public convenience and necessity to expand its existing gas transmission facilities (Expansion Project), filed its response to the pleadings of DRA, TURN, Kern River, and Altamont on February 26, 1991.

4. In D.87-12-039, the Commission specified that the default transportation rate should include a volumetric rate that recovered the following elements of the utility's revenue requirement: return on equity and associated taxes (equity-related costs), the percentage of administrative and general (A&G) expenses allocated according to annual throughput, and other charges such as franchise fees and uncollectibles, lost gas, and fuel use.

5. Failure to collect any portion of the firm transportation revenue requirement through volumetric rates renders the rate design adopted in D.90-12-119 incompatible with the Commission's gas transportation rate structure.

6. We will use the pipeline's desire to maintain low volumetric charges to reduce the overall cost of gas transportation, to develop a broader market of potential gas suppliers, and to lower prices to California consumers.

7. We prefer a modified fixed variable rate design for the Expansion Project.

8. Because the Expansion Project would not operate in a monopoly environment, the project sponsor and shippers should have the opportunity to negotiate a rate design that may better serve their interests.

9. In the absence of agreement between the project sponsor and shippers, the rate design for firm transportation service over the Expansion Project should consist of a two-part rate calculated to recover 93% of the project's annual revenue requirement.

a. The volumetric rate should be computed to recover 100% of the portion of the revenue requirement associated with equity related costs, uncollectibles, shrinkage and fuel use, and franchise fees.

b. The demand charge should be set residually to collect the remainder of the firm transportation annual revenue requirement.

10. Under our default rate design, 100% of the equity related costs will be collected in the volumetric rate.

11. Regardless of any risks or benefits associated with operation of the Expansion Project that may be reviewed in the Expansion Project rate proceedings, the Expansion Project's revenue requirement is not recoverable from non-Expansion shippers.

12. The Commission has advocated the "allocated incremental" allocation of costs of a pipeline expansion before the FERC. Under this methodology, existing ratepayers bear the cost of original facilities and incremental ratepayers pay the cost of added facilities. The cost of the portion of the original facility that is used by customers of the added facilities is allocated between existing and incremental ratepayers based on their relative usage of the upgraded facilities.

a. The only cost allocation methodology that will protect PG&E's existing ratepayers from the risk of overcapacity represented by the Expansion Project is allocated incremental cost.

b. PG&E must be authorized to collect the cost of service for the Expansion Project through allocated incremental cost based rates in order to avoid rolled-in ratemaking and the resultant transfer of the risk of overcapacity to PG&E's existing ratepayers.

13. The Expansion Project will pay for the use of the existing facilities without which the Expansion could not operate. A portion of the net book value of the facilities to be used, based on the ratio of Expansion project throughput to the total throughput over the augmented system, will be allocated to the Expansion.

14. The cost of original facilities allocated to the Expansion Project should be $1,942,261. The cost cap for the Expansion should be increased by this amount and first year annual revenue requirement should reflect this amount.

15. PG&E should demonstrate that its rates are sufficient to recover the annual revenue requirement associated with this cost. In the first Expansion general rate case, PG&E should propose an accounting mechanism for crediting PG&E ratepayers with these annual revenues.

16. We do not predicate our decisions on speculation whether FERC will employ rolled-in pricing for the interstate portion of the Expansion because, among other things, California consumers cannot be shielded from rate increases on competing pipelines due to FERC's rolled-in ratemaking by a simple denial of the Expansion CPCN. Substantial consumer benefits arising from increased pipeline competition would be foregone if the Expansion were denied due to the possibility of rolled-in pricing by the FERC.

17. A postage stamp rate is consistent with the rates we have designed for other intrastate gas transportation because it reflects the functionalization of the Expansion Project and the fact that delivery over the Expansion will be accomplished in large part through displacement.

a. Deliveries to northern California could not be accomplished without using the facilities at the southern end of the PG&E system.

b. The single delivery rate is necessary to enable PG&E to recover its costs of the Expansion, particularly since the Expansion rate is based on allocated incremental cost rate design.

c. Allowing Expansion shippers to use existing PG&E system capacity would negate our allocated incremental cost rate design and ultimately impose the risk of overcapacity from the Expansion project upon PG&E's existing ratepayers.

18. Whether PG&E will enjoy a competitive advantage in supplying gas to northern California because it has not proposed to pay the rate for transportation from Kern River station to destinations within its service territory cannot be determined until the first Expansion general rate case. If PG&E maintains its subscription to Expansion capacity, competitive issues will be reviewed at that time.

19. The FERC requirement that PGT hold a new open season for the initial allocation of all Expansion capacity does not vitiate our finding of market support for the Expansion. The intent to contract has been demonstrated by evidence of shipper interest in Canadian supplies, particularly by Southern California Edison and SDG&E, which had contracted for 300 out of 755 MMcf/d of Expansion capacity, and the commitment to the Expansion as the exclusive carrier for volumes specified in the Precedent Agreements.

20. Resolution G-2921 does not affect SDG&E's continuing need for access to the Canadian natural gas market.

Conclusions of Law

1. D.90-12-119 should be modified so that the Commission's determination of rate design and cost allocation for the Expansion Project is not inconsistent with the Commission's position on these issues at the Federal Energy Regulatory Commission.

2. D.90-12-119 should be modified to take official notice of a Commission resolution where the subject of the resolution is relevant to a finding in the decision.

3. Because of the significant impact of our resolution of the allocation and rate design issues on the efforts of PG&E to

executive firm transportation contracts for capacity rights on the Expansion, this decision should be effective today.

O R D E R

IT IS ORDERED that:

1. D.90-12-119 is modified as follows:

   a. The following findings of fact are added:

      198. Because the Expansion Project is being proposed in a competitive, instead of a monopoly environment, the project sponsor and shippers should be authorized to negotiate rates for firm transportation service that may better accomplish their objectives. The Commission will adopt a rate design that will be used if the parties have not negotiated their own rate design proposal. PG&E must submit its rate design proposal, whether it is a negotiated proposal or based on the Commission's default rate design, in the first Expansion Project general rate case.

      199. Under the Commission's intrastate default rate design adopted in D.87-12-039, the revenue requirement associated with return on equity and related taxes (equity-related cost), the administrative and general (A&G) expenses allocated according to annual throughput, franchise fees and uncollectibles, lost gas, and fuel use has been assigned for recovery in the volumetric portion of intrastate transportation rates.

      200. Before the FERC, the Commission has advocated volumetric transportation rates which recover 100% of the equity-related costs of the pipeline revenue requirement.

      201. The default rate design for the Expansion Project is consistent with prior Commission decisions and policies.

202. The default rate design for firm transportation service over the Expansion Project consists of a two-part rate calculated to recover 93% of the project's annual revenue requirement. The volumetric rate should be computed to recover the portion of the revenue requirement associated with the following cost items:

    a. 100% of the Expansion's return on equity and associated taxes.

    b. Shrinkage and fuel use.

    c. Franchise fees and uncollectibles.

203. One of the reasons to require recovery of equity-related costs through the pipeline volumetric rate is to create an incentive to maximize utilization of the pipeline.

204. None of the revenue requirements of the Expansion Project may be recovered from non-Expansion shippers. This will prevent the negotiations from shifting risk from the project sponsor and shippers to PG&E's existing ratepayers. This will also encourage the parties to maximize pipeline throughput.

205. At the FERC, the Commission has advocated an "allocated incremental" allocation of the cost of existing pipeline facilities to the shipper for whom added facilities were built.

206. Under the allocated incremental methodology, the cost of the portion of existing facilities used by the incremental shipper is allocated between existing ratepayers and the incremental shipper based on their relative throughput.

207. The capitalized net book cost of the existing PG&E pipeline that will be used by the Expansion Project is $1,942,261. This amount will be amortized over 30 years and included in the revenue requirement of the project. PG&E must propose a method in the first Expansion general rate case whereby the Expansion Project shall credit this amount annually to existing ratepayers.

208. The Commission does not base its decision to certificate the Expansion Project on speculation whether FERC will employ rolled-in pricing. The FERC may use rolled-in ratemaking on interstate pipelines seeking to compete with the Expansion Project. Denial of the certificate would not protect California consumers from the effects of the FERC's rolled-in ratemaking policy. Denial of the certificate would prevent California customers from realizing the benefits of competition that would be provided by the Expansion Project.

209. The use of a nonmileage based transportation rate (postage stamp rate) designed to recover the cost of Expansion service to Kern River Station is reasonable because of the functionalization and actual operation of the Expansion Project. The Expansion Project is intended to serve primarily the southern California market.

210. Transportation over the Expansion to northern California is accomplished in part through displacement of supplies currently received at PG&E's southern facilities. The receipt of Canadian gas at Malin, Oregon, for delivery in California depends on the diversion of Southwest gas to southern California.

211. The use of a postage stamp rate is reasonably necessary to recover the Expansion's cost of service and does not discriminate against northern California shippers nor unfairly lower the cost of transportation to southern California shippers.

212. The Preliminary Determination of Non-Environmental Issues (Preliminary Determination) for the PGT portion of the Expansion Project issued by the FERC on January 22, 1991 requires PGT to hold a new open season for the intial allocation of Expansion capacity.

213. The Preliminary Determination does not vitiate our reliance on the Precedent Agreements as indicators of market interest in the Expansion Project. The lack of a written document does not alter the market interest in Canadian gas. It does not necessarily follow that shippers have altered their commitment to use the Expansion as their sole means of transporting the volumes of gas specified in the agreements.

214. Resolution G-2921 does not affect the need of SDG&E for access to Canadian supplies of natural gas.

b. Finding of Fact 88 is deleted and replaced with the following:

88. The Commission should assign the benefits of economies of scale inherent in expanding PG&E's existing pipeline system to the incremental shipper user as an efficient allocation of resources. For this reason, a portion of the net book value of the existing facilities, and not the replacement cost of facilities, should be allocated to the incremental shippers.

c. Finding of Fact 90 is deleted and replaced with the following:

> 90. The adoption of "incremental plus" rates for the Expansion Project will compensate existing ratepayers for the incremental shippers' use of existing facilities.

d. Finding of Fact 190 is deleted and replaced with the following:

> 190. $738 million, consisting of $698 million for construction and $40 million for environmental mitigation, is the reasonable construction cost cap for the Expansion Project, as that term is defined by § 100.5 Subsection (a) of the PU Code.

e. Conclusion of Law 14 is deleted and replaced with the following:

> 14. It is reasonable to allocate a portion of the cost of commonly used facilities to the Expansion Project because the Expansion cannot function without the use of such facilities.

f. Conclusion of Law 16 is deleted and replaced with the following:

> 16. The modified-fixed variable rate design is appropriate for this transportation-only pipeline. However, the Commission may find that alternative rate designs may equally serve the Commission's objectives for the Expansion Project.

g. Ordering Paragraph 2 is deleted and replaced with the following:

> 2. The maximum reasonable cost of the proposed project pursuant to Public Utilities (PU) Code § 1005.5 shall be $738 million.

2. PG&E shall include testimony on its proposed Expansion Project rate design, including a proposed tariff, in the first Expansion Project general rate case. The rate design may be either the product of negotiations between PG&E and its shippers or based on the default rate design described in this decision.

3. In its first Expansion Project general rate case, PG&E shall show that the Expansion Project rates are adequate to recover the allocated incremental cost for the Expansion's use of existing facilities and shall propose a means of crediting existing PG&E ratepayers with the allocated cost.

4. If PG&E retains its subscription to the Expansion Project, the effect on competition of its transportation of gas from Kern River Station to its service territory will be reviewed during the first Expansion general rate case.

5. PG&E shall file with the Director of the Commission's Advisory and Compliance Division a copy of the Precedent Agreements to be executed pursuant to the Preliminary Determination of Non-Environmental issues for Pacific Gas Transmission Company's portion of the Expansion by the Federal Energy Regulatory Commission.

6. PG&E shall not collect any portion of the Expansion Project's revenue requirement from non-Expansion Project ratepayers.

7. The "Motion for Leave to Refile Comments of the Southern California Utility Power Pool Because of Nonconforming Certificate of Service," filed January 11, 1991, is denied.

This order is effective today.

Dated June 5, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
G. MITCHELL WILK
JOHN B. OHANIAN
DANIEL Wm. FESSLER
NORMAN D. SHUMWAY
Commissioners

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

NEAL J. SHULMAN, Executive Director