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Decision 92-02-042 February 10, 1992

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking into natural gas procurement and reliability issues.	R.88-08-018 (Filed August 10, 1988)
Order Instituting Rulemaking on the Commission's own motion to change the structure of gas utilities' procurement practices and to propose refinements to the regulatory framework for gas utilities.	R.90-02-008 (Filed February 2, 1990)

ORDER DENYING REHEARING AND MODIFYING DECISION (D.) 91-11-025

On November 13, 1991, the Commission issued Decision (D.) 91-11-025, which adopted rules governing natural gas utility brokering of interstate pipeline capacity. This decision is the most recent in the Commission's six-year process of restructuring the regulation of the natural gas industry in California. Nine parties have filed applications for rehearing of D.91-11-025: Independent Petroleum Association of Canada (IPAC), Canadian Petroleum Association (CPA), California Industrial Group, et al. (CIG), the State of New Mexico (New Mexico), Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SoCalGas), Southern California Edison Company (Edison), Cogenerators of Southern California (CSC), and Sunlaw Cogeneration Partners I, et al. (Sunlaw). Two parties have filed responses to the applications: California Cogeneration Council opposes the arguments of PG&E and supports those of the cogenerators, and Watson Cogeneration Company opposes the arguments of the cogenerators.

We have carefully reviewed each and every allegations of error raised in the above applications and considered the responses thereto, and are of the opinion that insufficient grounds for granting rehearing have been shown. However, in the course of discussing many of the issues raised by the applications, we provide in today's order additional discussion and clarification of our new capacity brokering program and rules, and, where appropriate, we make minor modifications to D.91-11-025. Any issues raised by the parties but not discussed in this Order are deemed to be without merit and are denied.

1. Preemption

CPA argues that our capacity brokering order and rules are preempted by federal law. CPA claims that only the Federal Energy Regulatory Commission (FERC) can regulate interstate capacity brokering on the Pacific Gas Transmission Company (PGT) system.

We do not dispute that the FERC must first authorize capacity brokering on interstate pipelines, such as PGT, before our capacity rules can be implemented. We also do not dispute that the FERC has jurisdiction to regulate the conditions under which such capacity brokering may take place. However, we disagree with CPA's argument that our capacity brokering order and rules are preempted by the FERC or the Natural Gas Act.

D.91-11-025 explicitly recognizes that there must be FERC authorization for interstate capacity brokering before the California local distribution companies (LDCs) can implement their capacity brokering programs. (D.91-11-025, pp. 2, 8-9, 37-39, & 76 (slip op.).) Rule VIII A. of our capacity brokering rules further provides that interstate pipeline capacity brokered by LDCs and rebrokered by their assignees must be in accordance with "applicable FERC and CPUC orders, FERC brokering certificates, and approved FERC and CPUC tariffs." (See D.91-11-025, Appendix B, p. 19 (slip op.).) Consequently, our rules are consistent with the FERC's regulation of interstate pipelines. There cannot be a conflict between our rules and the FERC's orders, because our rules require the LDCs and their assignees to conform their capacity brokering programs with the applicable FERC orders and FERC approved certificates and tariffs.

CPA relies upon Schneidewind v. ANR Pipeline Company (1988) 108 S.Ct. 1145, 1150, Exxon Corp. v. Eagerton (1983) 462 U.S. 176, and Natural Fuel Gas Supply Corp. v. Public Serv. Comm'n of New York, (2d Cir. 1990) 894 F.2d 571, cert. denied (1990) 110 S.Ct. 3240 to argue that if there is FERC regulation of an interstate natural gas corporation, the FERC authority must occupy the field to the exclusion of state regulation. However, these cases are inapposite. Our capacity brokering rules do not attempt to regulate interstate pipelines. Instead, our rules regulate how the California LDCs may exercise their rights on the interstate pipelines. It is clear that we have jurisdiction over the rates, services, and practices of PG&E, SoCalGas, and San Diego Gas and Electric Company (SDG&E), which are LDCs subject to our jurisdiction under Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), and are also Hinshaw pipelines subject to our jurisdiction under Section 1(c) of the Natural Gas Act, 15 U.S.C. § 717(c).

The California LDCs, like any other participants in interstate pipeline capacity brokering programs, must comply with the FERC's regulations on capacity brokering. In this regard, the FERC exercises "limited" jurisdiction over them. However, unlike the other firm shippers participating in the interstate pipelines' capacity brokering programs, the California LDCs must also be regulated by our Commission.

State commissions must have regulatory authority over the LDCs' brokering of their interstate pipeline capacity rights, because brokering significantly affects and is integrally related to important intrastate issues, such as the LDCs' public service obligations under state laws, intrastate rates (which include demand charges paid for firm interstate capacity), and curtailment rules designed to deal with emergencies. For example, in D.91-11-025, we had to make determinations as to how much capacity the LDCs must retain to serve core and core subscription customers, so that the LDCs would know how much interstate capacity they could broker to others without interfering with their public service obligations.

Thus, contrary to CPA's position, the FERC does not and cannot exercise exclusive regulation over the California LDCs' capacity brokering programs. As the FERC itself stated in Texas Eastern Transmission Corporation (1989) 48 FERC ¶61,378, p. 62,551, "the FERC's jurisdiction does not extend to the allocation of [interstate pipeline] capacity acquired by local distribution companies; that determination is left to the authority of state regulatory agencies."

In view of the above, we find no basis for CPA's argument that our capacity brokering order and rules are preempted by federal law. Our rules require the LDCs' conformance with FERC orders and are intended to protect important state interests by regulating how the California LDCs may broker their interstate capacity rights within the parameters set by the FERC.

2. Nondiscriminatory Access

A. End-user Preference

In D.91-11-025, we required the California LDCs to broker one-third of their available interstate capacity for one- to two-year periods in order to make capacity brokering a more attractive option to small and medium-sized customers. (D.91-11-025, p. 22 (slip op.).) CPA argues that to reserve this short-term capacity, so that it is only available for brokering to California end-users, is unduly discriminatory and contrary to FERC policies. Conversely, CIG seeks rehearing because we did not reserve firm capacity for brokering to only California end-users. Thus, CPA and CIG each have a completely different interpretation of our order and rules.

The source of this confusion apparently stems from the ambiguity in Rule VIII B. of our capacity brokering rules wherein we state: "Each LDC shall offer one-third of available capacity on a short-term basis whereby noncore customers may select firm interstate capacity for one- or two-year periods." (See D.91-11-025, Appendix B, p. 19 (slip op.).) CPA has narrowly interpreted the phrase "noncore customers" in this rule to mean that short-term capacity can only be brokered to California end-users, whereas CIG has broadly construed our order and rules to mean that short-term and long-term capacity should be available for brokering to all shippers, whether they are located inside or outside of California.

Our intent was always to authorize nondiscriminatory capacity brokering by the California LDCs, whether it was short-term capacity or long-term capacity. In D.91-11-025, we explicitly stated that "all producers and marketers would have an opportunity to participate in capacity brokering programs of the California LDCs." (D.91-11-025, p. 36 (slip op.).) We also rejected the reservation of capacity for California end-users that did not choose the core subscription option because, among other reasons, the 60 million therm cut-off for reserved capacity was "arbitrary and unduly discriminatory." (Id. at p. 23 (slip op.).) Moreover, our expressed reason for requiring short-term capacity brokering was to make it a "more attractive option to small and medium-sized customers" (Id. at p. 22 (slip op.)), and we never stated that the small and medium-sized customers could only be end-users in California.

We therefore clarify that the California LDCs must broker available interstate capacity on either a short-term or long-term basis to all interested shippers, whether or not they are end-users in California. To assure there is no more confusion in this regard, we will modify Rule VIII B. in Appendix B of D.91-11-025 by substituting the phrase "noncore customers" with "shippers." In light of this clarification, CPA's argument concerning discriminatory treatment for California end-users is moot.

We reject in this regard CIG's argument that end-users in California should have preferential access to the California LDCs' brokered capacity. CIG insists that established FERC policy is in favor of such preferential treatment. However, CIG has not cited any cases where the FERC has allowed end-user preference when other parties opposed such preference. Indeed, in CNG Transmission Corporation, (1991) 56 FERC ¶61,116, p. 61,448, which is cited by CIG, the FERC notes that it had refused to require end-user preference due to the Producer-Marketer Transportation Group's contention that this was unduly discriminatory. However, on rehearing, after the Producer-Marketer Transportation Group withdrew its objection, the FERC agreed to allow end-user preference because it was then unopposed and was integral to a comprehensive settlement. Moreover, in Texas Eastern Transmission Corporation (1990) 52 FERC ¶61,273, p. 62,051, which is also cited by CIG, the FERC refused to require end-user preference for brokered capacity.[1] Consequently, it is clearly not the FERC's policy to require state commissions to order the LDCs to provide preferential access to end-users.

In D.91-11-025, while we retained the core subscription option for end-users which did not seek competitive alternatives, we found no justification in the record for the 60 million therm cut-off for bundled service or for reserved capacity for end-users seeking firm transportation rights on the interstate pipelines serving California. (D.91-11-025, pp. 23 & 68 (slip op.).)

CIG maintains in its rehearing application that the eligibility cut-off is supported by record evidence. According to CIG, it was necessary to have a cut-off to prevent a few large customers from using all of the capacity reserved for end-users.

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1. The two other cases cited by CIG involved orders which the FERC subsequently vacated. (See El Paso Natural Gas Company (1991) 54 FERC ¶61,318, vacated, (1991) 56 FERC ¶61,289; Transwestern Pipeline Company (1991) 54 FERC ¶61,319, vacated, (1991) 56 FERC ¶61,288.) Vacated orders obviously do not constitute well-established FERC policy.

However, there was no justification in the record for reserving firm capacity for end-users in contrast to letting the end-users bid for the firm capacity in competition with marketers and producers.[2] In addition, if reserving capacity for some end-users were justifiable, there is no evidence in the record to support the cut-off being as large as 60 million therms. While we agree that smaller customers require a highly reliable, premium service and may not be able to compete with marketers or large customers, the 60 million therm cut-off would permit all but eight PG&E customers and ten SoCalGas customers to take advantage of the bundled service or reserved capacity for end-users. Consequently, the 60 million therm cut-off cannot be justified on the basis that it is needed to protect smaller customers. Moreover, we have not been presented with any evidence as to why large end-users need any special protections and cannot compete for capacity with marketers or producers.[3]

CIG further argues in its rehearing application that competition for interstate pipeline capacity is not a "proper regulatory goal," because it will increase rates and provide an opportunity for excessive rates. We disagree with CIG's arguments.

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2. CIG alleges in its rehearing application that the bundled service or reserved capacity would actually be unattractive for various reasons (e.g., the requirement of rates at 100% of the as-billed interstate rate; the inability to acquire interruptible intrastate service at discounted rates). If this is true, we are left to wonder why bundled service or reserved capacity for end-users is even necessary, let alone not unduly discriminatory.

3. CIG argues that our rejection of reserved capacity for end-users is arbitrary and capricious because CIG does not believe we found fault with SoCal reserving 225 MMcf/d for end-users. However, we have found no basis in this record for reserving capacity for end-users of SoCal or PG&E, particularly under such a large eligibility cut-off.

First of all, the rates charged by the LDCs for brokering capacity are limited by the as-billed rate cap. The LDCs cannot charge more for interstate capacity than the rates they are charged by the interstate pipelines. Consequently, there is no opportunity for "excessive" rates.

Secondly, requiring nondiscriminatory brokering programs with a greater amount of capacity to be brokered (than what would have been available under the settlement) will make the brokering programs more attractive and encourage greater participation. While CIG complains that this increased competition may cause higher rates (up to the as-billed rate cap), what this really means is that the LDCs will have a greater opportunity to be reimbursed for the demand charges or reservation charges of interstate pipelines that were previously recovered in the LDCs' intrastate rates from all of their customers. Consequently, there is no increase in rates to California consumers, since the LDCs will be able to unbundle the interstate pipeline demand charges or reservation charges from the LDCs' intrastate rates to the extent that they are reimbursed for these charges under their brokering programs. Moreover, the rates charged by the LDCs will be more equitable in that the shippers that successfully bid for firm interstate capacity rights will have to pay higher rates for firmer transportation service and the shippers that do not obtain firm transportation rights will then pay lower rates.

B. Special Protections for the Core

CIG contends that it is unduly discriminatory for LDCs to assign to core aggregators a portion of the firm capacity reserved for the core market without also providing for the direct assignment of firm interstate capacity to noncore end-users. We reject CIG's argument due to the long-recognized distinctions between core customers and noncore customers.

Core customers have always had the highest priority among LDC customers, not only because of the nature of their needs and their size, but also because of their lack of alternate fuel capability. Thus, in D.91-02-040, we found that it was sensible to curtail all noncore customers before core customers "because, by definition, noncore customers have supply options not available to core customers." (Re New Regulatory Framework for Gas Utilities [D.91-02-040] (1991) 39 Cal.P.U.C.2d 360, 363.) It is therefore critical that aggregators of core loads be provided with the direct assignment of firm capacity rights rather than risk losing some of their reserved capacity in a competitive brokering program. Without alternate fuel capability, the loss of firm capacity rights (or any portion thereof) could be much more devastating to core customers than to noncore customers.

It should also be noted that core customers as a class have paid a higher share of the interstate pipeline demand charges than noncore customers, because these costs have been allocated to the core on the basis of cold year annual sales. (See Re Rate Design for Unbundled Gas Utility Services [D.86-12-009] (1986) 22 Cal.P.U.C.2d 444, 466.)

Consequently, it is not unduly discriminatory to provide for the direct assignment of firm interstate rights to core aggregators and not to noncore end-users, given that the core class has always had the highest priority of service and has been paying for a higher share of the LDCs' interstate pipeline demand charges or reservation charges.

C. Intrastate Capacity Rights

CPA and New Mexico argue that it is unduly discriminatory to provide only end-users with intrastate capacity rights. They maintain that marketers and producers should also be allowed to obtain intrastate service.

In D.91-11-025, we stated that if marketers or brokers over which we had no jurisdiction were to obtain intrastate rights at a time that intrastate capacity was scarce, it could compromise our obligation to protect consumers in California. (D.91-11-025, p. 20 (slip op.).) CPA and New Mexico point out that we also do not have jurisdiction over the California end-users. However, unlike marketers who could command economic rents from end-users if the marketers obtained scarce intrastate capacity, the end-users would not attempt to exploit themselves. Thus, our lack of jurisdiction over end-users is not a reason to assume that they would not be protected from exploitation when they had their own intrastate capacity rights.

Since open access is required in California, we also do not believe that marketers or producers outside of California can be exploited by the California end-users. In sharp contrast to the Access Agreement, which restricts Canadian gas sales such that the gas may be purchased from only certain Canadian producers and in only certain proportional amounts, a marketer or producer in Canada or New Mexico is free to sell gas to any of the hundreds of noncore end-users and core aggregators in California, as well as to the California LDCs and their wholesale customers. In addition, in D.91-11-025, we found it appropriate to allow end-users to delegate their intrastate transportation rights to non-customer shippers in order to provide additional flexibility. (D.91-11-025, p. 20 (slip op.).) Consequently, even without brokering of intrastate capacity rights, there is still nondiscriminatory, open access in California.

In any event, we simply did not have a record to develop intrastate capacity brokering at this time. However, in D.91-11-025, we directed the California utilities to propose mechanisms whereby holders of firm capacity could sell their priority to others if curtailments were to occur. (Id.) We also indicated that we would consider in the future a more flexible way to allocate intrastate capacity which would permit a more efficient use of the intrastate system. (Id.)

3. Conversion

CPA maintains that our requirement that PG&E convert 100% of its firm sales entitlement to firm transportation rights by October 1, 1992 conflicts with the regulatory policies and objectives of the FERC. To support its argument, CPA refers to the FERC's conversion regulations and to the sales customer's option to convert up to 15 percent of its firm sales entitlement to firm transportation during the first twelve months of the schedule therein. (See 18 C.F.R. §284.10.)

First of all, these conversion regulations merely provide options to firm sales customers. They do not in any way preclude the sales customers and the interstate pipelines from agreeing to 100% conversion ahead of the schedule in the regulations. Thus, if PG&E and PGT agreed to 100% conversion rights by October 1, 1992, there is nothing in the FERC regulations that would prevent it.

Secondly, there is no conflict between PG&E's conversion to firm transportation rights and the FERC's regulatory policies and objectives. Indeed, in its notice of proposed rulemaking in FERC Docket No. RM91-11-000 (the "MEGANOPR"), the FERC has proposed a rule requiring the unbundling of the pipelines' sales function from their transportation function at upstream locations. (See <u>In Re Pipeline Service Obligations, Etc</u>. (1991) IV FERC Stats. & Regs. ¶32,480, pp. 32,545-32,546.) On the PGT system, such unbundling would require PG&E to convert 100% of its firm sales entitlement to firm transportation rights so that PG&E would make its purchases of gas at the Canadian border. Consequently, our requirement that PG&E convert its sales entitlements to firm transportation rights is consistent with FERC policies and objectives.

Finally, it should be noted that under the FERC's conversion regulations, PG&E would have the right to convert up to 75% of its firm sales entitlement to firm transportation rights on October 1, 1992 even without PGT's concurrence. PGT initiated open access interruptible transportation on August 1, 1989 pursuant to the FERC's July 28, 1989 order. (See <u>Pacific Gas Transmission Company</u> (1989) 48 FERC ¶61,125.) Consequently, our October 1, 1992 conversion requirement would take place during the fourth twelve-month period after PGT commenced open access transportation. Accordingly, PG&E's conversion rights on October 1, 1992 would be up to 75% of its sales entitlement (not just up to 15% of its sales entitlement) under the FERC's conversion regulations. (See 18 C.F.R. §284.10(c)(3)(D).)

4. Access Agreement

CPA and IPAC claim that D.90-09-089 had adopted the Access Agreement and that the Access Agreement was not intended to be flexible. Instead, CPA and IPAC maintain that the Access Agreement was intended to continue regardless of whether capacity brokering became implemented. Consequently, CPA and IPAC contend that our capacity brokering order erred by not adhering to the Access Agreement.

In D.90-09-089, we explicitly stated that we did not and cannot adopt the Access Agreement. We only recognized the Access Agreement as an effective means to implement the rules we adopted. (Re Gas Utility Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities [D.90-09-089] (1990) 37 Cal.P.U.C.2d 583, 618.) The rules we adopted governed the procurement practices of the California LDCs. And we made explicitly clear in D.90-09-089 that we regarded the rules as interim in nature pending final resolution of capacity brokering. (Id. at pp. 589, 608, and 626.) We further stated on rehearing that capacity brokering would supersede these interim rules, which merely represented a transitional phase. (See Re Gas Utility Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities [D.91-02-022] (1991) 39 Cal.P.U.C.2d 321, 325.)[4]

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4. Of course, we have authority to subsequently change our rules when we believe that circumstances warrant it. But in D.90-09-089 and D.91-02-022, when we first adopted the rules, we had given notice that these interim rules would be superseded when capacity brokering could be implemented. Thus, no change in our policy has even occurred.

In view of the above, we reject CPA's and IPAC's arguments concerning the Access Agreement. IPAC is simply wrong when it alleges that we adopted the Access Agreement as an exception to the interim nature of our procurement rules. When we stated in D.90-09-089 and in D.91-02-022 that these rules were interim, we never stated or indicated that there was any such exception for gas being transported on the PGT system.

5. Interference with Contracts

CPA and IPAC further argue that our brokering order would violate policies regarding the sanctity of contracts, including the FERC's policy respecting existing contractual obligations.

The FERC, however, has refused to require PG&E to purchase gas from PGT and its affiliate, Alberta and Southern Gas Company Ltd. ("A&S"), notwithstanding A&S' and PGT's contractual commitments. On January 24, 1990, the FERC found PGT's minimum bill was "unjust and unreasonable" notwithstanding PGT's claims that its minimum bill was a "necessary component of its contractual relationship with the Canadians." (See Pacific Gas Transmission Company (1990) 50 FERC ¶61,067, pp. 61,131-61,132.)

Our policy, consistent with the FERC's policy, is to promote competition in the sales of natural gas. If we could be required to allow PG&E to monopolize access on the PGT pipeline due to contracts entered into between PG&E's unregulated affiliate and others, our ability to protect the public from monopolistic practices would be undermined. Section 761 of the California Public Utilities Code, however, provides the Commission with authority to regulate the practices and services of public utilities to ensure that such unjust and unreasonable practices do not occur. (Pub. Util. Code, §761.)

As we stated in D.91-11-025, we are committed to improving competition in gas markets in order to lower the price of gas and promote the efficient use of interstate pipelines serving California. (D.91-11-025, pp. 5-6 (slip op.).) Capacity brokering serves these objectives. For these reasons, we will not allow contracts between A&S and Canadian producers to prevent the achievement of our objectives by dictating the way in which we may regulate PG&E's practices and services.

6. Core Subscription Service

In D.91-11-025, we allowed up to 50% of UEG average annual gas requirements to be met through core subscription service during the first two years of the program. During the third and fourth years, UEGs may use core subscription service for up to 25% of their average annual gas requirements. Beginning the fifth year, UEGs may not use core subscription service. (D.91-11-025, p. 46 (slip op.).)

New Mexico argues that there is no justification for allowing UEGs to elect core subscription service, because the purpose of core subscription is to provide a premium service for noncore customers which may not be able to compete for firm transportation and gas supplies and do not seek competitive alternatives. New Mexico contends that UEGs do not fit this category and, therefore, should not be entitled to opt for core subscription service.

While we agree that UEGs should eventually not be able to opt for core subscription service, we believe that it is reasonable to provide for a transition period, since UEGs of combined utilities have historically relied upon their gas departments. We therefore reject New Mexico's arguments against our scheduled phasing out of the core subscription option for UEGs, although we share New Mexico's goal of requiring UEGs to make their own gas purchases.

7. 70% Minimum Bid

CIG argues that there is no evidentiary support for a minimum bid of 70% of the as-billed cap for brokered capacity. This is a rather surprising argument, since CIG itself supported this 70% minimum in the hearing. However, we have now reconsidered this issue and see no policy justification for this minimum. We will therefore modify D.91-11-025 accordingly.

It should not be inferred from this modification that the California LDCs should accept unreasonably low bids for brokered capacity. We are simply removing this minimum requirement for shippers to be able to submit bids.

8. The Taking and Equal Protection Issues

A. Reservation of Interstate Capacity for PG&E's UEG

In D.91-11-025, the Commission did not adopt the settlement provision by which PG&E would reserve 400 mmcf/d of firm interstate capacity for its UEG, thus this capacity was made available to interested shippers. PG&E argues that as result, a transfer of its alleged property rights on the interstate system has occurred, which constitutes an unlawful taking without prior compensation.

In D.91-11-025, the Commission found the argument that such pipeline transportation service constituted a property right was without merit. (D.91-11-025, p. 41 (slip op.).) As stated in this decision, "PG&E's rights over the interstate pipelines are rights associated with PG&E's status as a customer of the interstate pipeline companies. Associated rates for transportation services are tariffed. PG&E receives service on behalf of its customers who pay the full tariffed costs of the service." (D.91-11-025, p. 41 (slip op.).)

Even assuming arguendo that PG&E has a property right over its interstate capacity, the assignment of firm interstate capacity by PG&E does not constitute a compensable taking. The facts of this case and the law support this position.

The general law concerning whether the Commission's regulation constitutes a taking can be found in Pacific Telephone and Telegraph Company v. Eshleman (1913) 166 Cal. 640. In this decision, the California Supreme Court held that "when an order passes beyond proper regulation it amounts to a taking of the property and the order is then referable not to the police power but to the power of eminent domain." (Id. at p. 663; see also, Twain Harte Associates, Ltd. v. County of Tuolumne (1990) 217 Cal.App.3d 71, 83-84.) "(R)egulation of use within the dedicated use is as far as the police power may be extended and that when the regulation exceeds this, it is always void for unreasonableness and may, depending upon the form and character of the order, be also void as an attempt to take property without compensation in violation of constitutional protection." (Pacific Telephone Etc. Co. v. Eshleman, supra, 166 Cal. at p. 680.)

However, the Court went on to say that:

> ". . . the vitally essential principle limiting the exercise of the police power and distinguishing it from the exercise of the power of eminent domain, is that private rights in the former case must, for the benefit of society, yield to reasonable regulations controlling the use of property, in the case of public utilities, within the use to which the property has been dedicated. The law has the power to regulate the use to increase efficiency and prevent abuses, and such regulations, though they involve an expenditure of money or a modification of the use, are regulations which the law-making power may impose by virtue of the very fact that the property has been dedicated to that public use." (Id. at pp. 677-678.)

Thus, the question is whether, in the instant case, the Commission's regulation has gone too far. It has not, for the following reasons.

The Commission has the authority or police power to regulate the allocation of interstate capacity acquired by local distribution companies, such as PG&E. (See D.91-11-025, p. 40 (slip op); Texas Eastern Transmission Corporation, supra, 48 F.E.R.C. ¶61,378 at p. 62,551.) This authority comes from Public Utilities Code Section 761 which places an obligation on the Commission to assure that utility services are reasonable. (See Pub. Util. Code, §761; see also, D.91-11-025, p. 40 (slip op.).) The transportation of natural gas constitutes a utility service, and the Commission has the authority and responsibility to assure that its allocation is reasonable. Even PG&E acknowledges this authority in its rehearing application. (Application of Pacific Gas and Electric Company for Rehearing of Decision 91-11-025, p. 3.)

In exercising its police power, the Commission has required PG&E to make available firm interstate capacity because it serves the public interest, namely, competition in gas procurement and economic efficiency. The California Supreme Court has found that competitive considerations are an important element of the public interest. (See <u>Northern California Power Agency v. Public Util. Com.</u> (1971) 5 Cal.3d 370, 377-378.) In R.90-02-008, the Commission made clear its "intent to reduce the utilities' role in procurement markets because of the potential for anticompetitive activity." (<u>Re Refinements to the Regulatory Framework for Gas Utilities</u> [D.90-07-065] (1990) 37 Cal.P.U.C.2d 87, 95.)

As the Commission stated in D.91-11-025,

> "a vertically integrated industry, whereby a utility purchases, transports and distributes all gas used in its service territory, does not serve the best interests of California customers under existing circumstances. The Commission has also found that certain classes of customers should have an opportunity to purchase their own supplies. We have also stated that the utilities' exclusive access to firm interstate pipeline capacity does not serve the best interests of customers." (D.91-11-025, p. 40 (slip op.).)

This is the reasoning for the Commission's decision to require PG&E to change the way it offers transportation and to require PG&E to assign firm capacity rights to shippers. (D.91-11-025, p. 40 (slip op.).)

In sum, the rights associated with the firm interstate capacity have been dedicated by PG&E to public use. In exercising its police power, the Commission is not changing the use of the dedicated property, but rather is requiring PG&E to assign this capacity to shippers on the basis of the public interest, important elements of which are increasing competition and generating economic efficiency, resulting in consumer benefits. (See D.91-11-025, p. 44 (slip op.); see also, Re Gas Utility Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities, supra, 37 Cal.P.U.C.2d at p. 588; Re Natural Gas Procurement and System Reliability [D.88-12-099] (1988) 30 Cal.P.U.C.2d 545, 549-550.) Thus, the Commission's regulation has not gone too far. As noted above, the power to regulate the use of property to increase efficiency and prevent abuses, even though it involves an expenditure of money or a modification of use, does not constitute a taking. (Pacific Telephone Etc. Co. v. Eshleman, supra, 166 Cal. at pp. 675 & 678.)

In citing Eshleman, PG&E is arguing that the Commission's refusal to allow PG&E to reserve 400 mmcf/d of firm interstate capacity, even for competitive reasons, constitutes a unlawful taking, similar to the "taking" in Eshleman. However, the facts in the instant case are distinguishable from those in Eshleman. In the latter case, the Commission had ordered Pacific Telephone and Telegraph Company to permit a physical connection or connections to be made between its telephone lines and the lines of two complainant companies, and failed to provide compensation for the taking of property at the time it occurred. (Pacific Telephone Etc. Co. v. Eshleman, supra, 166 Cal. at pp. 646 & 686.) As the Court noted, "[t]he commission has at no time contended or admitted that any compensation is due petitioner for a taking of its property. The compensation referred to is compensation to be paid to petitioner for services rendered in receiving and transmitting long distance telephone messages." (Id. at p. 686.) Thus, the Court concluded "of course it cannot be contended and is not contended that an apportionment of rates or tolls for a service to be rendered in the future is a compensation for the present taking of property, and as little can it be said that the allocation of such rates and tolls to be earned in the future can ever measure up to the constitutional requirement that property shall not be taken without compensation first made and paid to the owner." (Id. at pp. 686-687, emphasis added.)

However, in the instant case, no present taking has occurred which requires compensation. Rather, when the firm interstate capacity is assigned in the future, the assigner will pay for the capacity as a service. Rates for such assigned capacity will be based upon the highest bids in the open season subject to the as-billed rate cap, prior to the assignment. During the implementation phase of these proceedings, we will also decide how PG&E can recover in intrastate rates all reasonably and prudently incurred demand charges on the interstate pipelines that are not recovered from assignees. PG&E's collection through the bidding process of the open season and through its intrastate rates (as decided in the implementation phase) will all happen prior to or contemporaneous with the brokering of firm capacity rights.

This comports with the Court's thinking in Eshleman. The Court pointed to cases where if "there is no change of use, and consequently no taking of property, but there is a regulation of use, ... the compensation to be allowed need not necessarily be compensation paid in advance other than such as will equitably compensate for the cost of connection, but will be a compensation for the future service which may be fairly adjusted by rates and tolls." (Pacific Telephone Etc. Co. v. Eshleman, supra, at 166 Cal. at p. 684.) Since no capacity has yet been assigned, there is no need for compensation until such an assignment has occurred.

Further, PG&E's argument apparently is based on its concerns about having to make capacity available to its competitors, e.g. marketers, brokers, and producers. (Application of Pacific Gas and Electric Company for Rehearing of Decision 91-11-025, p. 3.) However, absent a statutory mandate, the "[f]reedom from competition is not a compensable property right under the provisions of the California Constitution, article I, section 19." (Peerless Stages, Inc. v. Santa Cruz Met. Transit Dist. (1977) 67 Cal.App.3d 343, 347.)

B. A&S Liability for Contractual Shortfalls

In D.91-11-025, the Commission ordered PG&E "to convert its firm sales right to firm transportation rights over PGT as soon as possible, but in no event later than October 1, 1992," and "to implement a nondiscriminatory capacity brokering scheme on the PGT system by October 1, 1992 or within 60 days of a FERC rehearing order authorizing capacity brokering on the PGT system, whichever is later." (D.91-11-025, p. 38 (slip op.).) PG&E contends that these mandates in the decision will result in substantial risks and financial liability as a result of contractual shortfalls for PG&E's wholly owned subsidiary, A&S, and thus PG&E's property rights have been "damaged," under Article I, Section 19 of the California Constitution, such that PG&E would be entitled to prior compensation.

The record does not support a "taking" as alleged by PG&E. In fact, matters relating to costs were reserved to PG&E's next reasonableness review. (D.91-11-025, p. 37 (slip op.).) Also, the record does not disclose what effects, if any, the contracts between PGT and A&S and between A&S and the Canadian producers will have on PG&E, in relation to the implementation of the capacity brokering program. Further, the record does not prove that such alleged contractual shortfalls could or would occur, that PG&E would be liable, or the extent to which PG&E would suffer any damages. Moreover, if there were PG&E liability and damages, there is no record on the issue of whether such damages are solely the result of Commission regulation, and not the result of the operation of economic forces in the market place. The latter occurrence is not compensable. As the U.S. Supreme Court explained, since "regulation does not assure that the regulated business make a profit," the regulatory agency is not required "to insure values or to restore values that have been lost by the operation of economic forces." (Market Street Railway Co. v. Railroad Commission of the State of California

(1945) 324 U.S. 548, 566-567; see also FPC v. Natural Gas Pipeline Co. (1942) 315 U.S. 575, 590, which held that "regulation does not insure that the business shall produce net revenues.") If this is the law for regulated business, this is also true for an unregulated business like A&S.

Consequently, the record does not support a showing of "any deprivation significant enough to satisfy the heavy burden placed upon one alleging a regulatory taking." (Keystone Bituminous Coal Assn. v. Debenedictis (1986) 480 U.S. 470, 493.) PG&E will have an opportunity in its next reasonableness review to produce evidence in support of its allegations that the implementation of the capacity brokering rules will result in contractual shortfalls which will subject A&S to financial liability, and that such a liability constitutes a compensable regulatory taking. It will also have the opportunity, if a "taking" has been proven, to establish the compensable amount of "damage" which it alleges has occurred as a result of regulation by the Commission. Further, this will give other parties a forum to challenge these allegations, perhaps by showing that the contractual shortfalls might be the result of economic forces or due to the imprudence of A&S, PG&T or PG&E.

9. Allocation of Unrecoverable Costs to the Noncore

Both Edison and SoCalGas contend that the decision's allocation of all unrecoverable intrastate transportation costs only to noncore customers violates Section 1708. Specifically, the utilities argue that because the following holding departs from Commission precedent and policy without providing parties with notice and an opportunity to be heard, the Commission committed legal error:

> "We adopt the settlement's rate design proposal for intrastate transportation with the condition that revenues which are not recovered from individual noncore customers be borne by the noncore class only."

In raising this issue, Edison and SoCalGas have pointed out an inadvertent clerical error. The above language was contained in the Administrative Law Judge's proposed decision, but should have been deleted from D.91-11-025, because the Commission decided to consider "[r]evenue shortfalls resulting from intrastate transportation rate discounts to noncore customers and stranded costs associated with noncore transportation services . . . in a later phase of this proceeding." (See D.91-11-025, Conclusion of Law Number 20, p. 74 (slip op.).) D.91-11-025 will be modified accordingly.

10. Shareholder Risks for Unmarketable Firm Capacity Reservations

In its rehearing application, SoCalGas contends that our discussion on page 54 of D.91-11-025 of TURN's concern that shareholders should assume some risks for unmarketable firm capacity reservations amounted to a decision on the merits of the issue. However, this contention is incorrect, because it is based on a misunderstanding of the intent of our discussion. We were merely raising the issue as set forth in TURN's arguments. In fact, the decision left the issue of allocation of risks between shareholders and ratepayers to the next phase of the proceeding. In Conclusion of Law Number 20, we reserved the issue, by stating: "Revenue shortfalls resulting from . . . stranded costs associated with noncore transportation services should be considered in a later phase of this proceeding. Revenue shortfalls associated with noncore services should also be considered in a later phase of this proceeding." (D.91-11-025, Conclusion of Law Number 20, p. 74 (slip op.).) Because the discussion did lead to SoCalGas' misunderstanding, we will modify D.91-11-025 to clarify this intent.

11. <u>Long-term Contracts</u>

CSC and Sunlaw (comprising, in addition to Sunlaw, AES Placerita, Inc., Destec Energy, Inc., and Berry Petroleum Co.)[5] both allege that the Commission in D.91-11-025 has impermissibly interfered with their long-term contract rights, in contravention of the Commission's own precedent and in violation of constitutional principles prohibiting the impairment of contracts. We note at the outset that with regard to the constitutional claims, neither applicant cites any case or other authority to support the argument that the type of regulatory change promulgated by us in D.91-11-025 is an impermissible infringement of contract rights.

CSC argues first that contract cogenerators should be given firm service at their contract rate - a rate which has been negotiated with the LDCs and is, for virtually all contract customers, less than the default rate. Secondly, Sunlaw and CSC both maintain that specific provisions of existing long-term contracts require that those agreements be deemed to be 100% default rate for curtailment purposes.

Sunlaw and CSC contend that while the Commission states it intends to honor existing long-term contracts, D.91-11-025 in effect destroys these agreements by failing to honor the contract provisions governing reliability of service and curtailment priority. This they argue is because virtually all other customers are paying the full default rate, which means that

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5. Many of the customers represented by these applicants are enhanced oil recovery (EOR) customers.

Issues similar to those discussed herein have been raised with regard to our current transportation rules, in applications for rehearing filed by the following similarly situated parties: Sunlaw (jointly with AES Placerita, Inc.) and Harbor Cogeneration Company (jointly with Kern River Cogeneration Company, Midway-Sunset Cogeneration Company, and Sycamore Cogeneration Company). We resolve those applications today in D.92-02-043.

customers with long-term contracts who pay less than the default rate would be penalized - in terms of curtailment priority - because of their contract transportation rate. These applicants argue the decision fails to honor the "heart of the agreements" - the service provided for the rate paid.

Two parties have filed responses to these applications for rehearing. California Cogeneration Council supports the applicants' arguments; Watson Cogeneration Company (Watson) strenuously disputes them. We basically agree with Watson's position.

These applicants, in recounting the history of the Commission's position with regard to long-term contracts, cite D.86-12-009 for the proposition that the Commission gave EOR customers assurances that long-term contracts would be honored despite any changed circumstances which could be pointed to by a future Commission. These assurances came primarily in the form of the Commission's having waived the provisions of Sections IX and X of General Order 96-A which require long-term contracts to be made subject to future modification by the Commission. Sunlaw and CSC maintain that the Commission has an obligation to abide by its assurances because of "basic constitutional principles prohibiting the impairment of contracts."

We note that while Sunlaw and CSC have been quick to point out our prior statements which lend support to their argument, they have not acknowledged other statements which have conditioned our assurances. For example, in D.86-12-009 we stated:

> "There is no disputing that the amount of excess intrastate utility capacity will change over time in response to changing demands on the utilities' customer base. What we can say today with confidence is that the California utilities currently have considerable excess capacity which is projected to decline gradually but should persist well into the 1990's. As a result, EOR customers as well as other noncore customers have reasonable assurance of high

transmission reliability (no curtailment in a cold year) <u>during at least the next several years</u>. During this time, negotiated EOR rates could conceivably approach the variable cost of transmission currently estimated at 1 cent per therm. [Footnote omitted.] Under these circumstances, and in view of significantly reduced EOR gas demand levels, most producers' need for higher priority due to the perceived possibility of curtailment has been lessened, and <u>it [sic] unlikely that most producers will elect to 'buy up' to a higher priority level during the next several years, even though that option will be available to them</u>.

"<u>In the longer term, EOR customers may have to pay rates above variable transmission cost in order to assure the same high level of reliability that exists today. In this sense, EOR customers will 'compete' with other noncore customers for reliability.</u>" (<u>In re Rate Design for Unbundled Gas Utility Services</u>, <u>supra</u>, 22 Cal.P.U.C.2d at pp. 482-483, emphasis added.)

In D.90-09-089 we stated:

"Our rules will not require changes to existing contracts. That does not mean, however, that regulation and the terms and conditions of existing utility tariffs and other rules cannot change during the term of existing contracts. In fact, we have made the parties aware on several occasions that our gas policies may change as circumstances change. . . . These statements, issued before the EOR contracts were signed, made clear that priority for transportation services could change so as to require different pricing policies. We hardly need add that California is currently in a position of constrained pipeline capacity, thus warranting the changes we make by this order." (<u>Re Gas Utility Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities</u>, <u>supra</u>, 37 Cal.P.U.C.2d at p. 613.

We reiterate once again that it is not and has not been our intention, in either our existing transportation rules or our new capacity brokering rules, to change the terms of the long-term contracts at issue here. However, as we anticipated over five years ago, circumstances have changed. Demand for capacity exceeds its availability, and we have been compelled by our regulatory responsibilities to recognize these changed circumstances as our regulation of gas transportation has evolved.

The contracts these customers negotiated provide for interruptible service at discounted rates. They never provided for firm service, and do not do so now. Under our present transportation rules, long-term contract customers are only entitled to Service Level 3, an interruptible service; they are not entitled to firm service unless they pay an additional surcharge. See D.90-09-089 and D.91-02-022, supra. Our new capacity brokering rules continue this treatment by requiring that if long-term contract customers, including cogenerators, wish to have firmer intrastate transportation service, they will have to pay for it as will all other noncore customers desiring the same service. CSC has not provided us with any justification for changing our rules to put them in a better position regarding firm service than they have ever been in. Moreover, such treatment would unduly discriminate against other noncore customers who do not have long-term contracts.

Our new capacity brokering rules require that customers be curtailed according to the level of payment (in terms of percentage of the default rate) they make for transportation service. This is a further step toward our goal, first articulated in D.86-12-009, of determining service priorities based on the value customers place on firmness of service. Contract customers will now be entitled to the same position in the curtailment queue as other noncore customers if they pay the same price, with the exception of retaining superior curtailment rights over UEG customers paying the same price. D.91-11-025 recognized that most of the long-term contracts have anticipated changed circumstances by including a provision authorizing negotiation of priority charges if they are ordered by the Commission. While we have not in fact adopted priority charges, we have adopted the equivalent.

The applicants argue that we are incorrect in categorizing the above requirement as the equivalent of priority charges. They contend that our rules impermissibly tie curtailment to the entire transportation rate paid, rather than to a specific charge which determines only priority, which means that they must "tear up" their transportation contracts to be able to compete equally with other customers for reliability.

We fail to see the significance of the distinction they point out. While we have not adopted a "priority charge" per se, we have developed the priority charge concept into a workable format. As with a priority charge, curtailment under our new rules will be determined based on the price paid. In our view, this is certainly equivalent to an explicit priority charge. As we have noted, most of the long-term contracts contain a provision that if the Commission adopts a priority charge system, contract customers can negotiate such a charge with the utilities. We have stated in D.91-11-025 that contract customers may renegotiate the rates they pay based on their own needs under our new rules. We expect that the utilities will honor this, and if requested to do so, will renegotiate with these customers in good faith.

In sum, as we have progressed toward our ultimate goal of a competitive natural gas market, we have consistently moved in the direction of requiring that transportation price will be the primary determinant of service priority. Long-term contract customers, as represented by these applicants, have just as consistently refused to recognize and accept this direction. However, this does not mean that we have impaired their contract rights; their contracts remain in full force. Their contracts never guaranteed them firm service at the rates they negotiated;

moreover, it would be inconsistent with our regulatory goals and discriminatory toward other noncore customers to give them this guarantee now, or to deem their discounted contract rates to be 100% default rate. They do now have the same opportunity as other customers to bid for and obtain firm service, if they are willing to pay for it. As we have in the past, we continue to assure cogeneration customers, with or without long-term contracts, superior priority rights if they pay the same price for service as UEG customers.

The changed circumstances of the market, which have dictated our changing regulations, have had an effect on long-term contract holders. That effect, however, has been to treat those contract holders <u>more equitably</u> relative to other noncore customers. Some of those contract customers' earlier advantages, which they experienced under their contracts in a time of few capacity constraints, are now gone. But that is not the same as substantially impairing their contract rights. We will deny their applications.

IT IS ORDERED that D.91-11-025 is modified as follows:

1. The word "shippers" shall replace the words "noncore customers" in Rule VIII B. of Appendix B to D.91-11-025.

2. The paragraph on the bottom of page 57 and the top of page 58 is modified to read:

> "We find the bidding proposals of the utilities acceptable with two exceptions. First, we see no reason for the 70% minimum bid requirement, and, therefore, it should be removed from the bidding requirements. Second, as we stated previously, the utilities should offer shorter term brokering. For PG&E, customers should have the option to purchase firm capacity for one year as well as two years. For SoCalGas, customers should have the option to purchase firm capacity for one to two years, as well as the longer terms proposed by the settlement. These shorter term arrangements will encourage more customers to bid for capacity during the early years of the program. Each utility shall make one-third

of its available capacity available for these shorter term periods."

3. The first sentence in the third full paragraph on page 49 is deleted. The third sentence of this paragraph is modified to read as follows: "We adopt the settlement's rate design proposal for intrastate transportation, and will consider the appropriate allocation of revenue shortfalls in a later phase of this proceeding."

4. The following language is added after the third full paragraph on page 54:

> "Although we agree with TURN's arguments about allocating some risk to shareholders, the issue of risk sharing or stranded investment cost will be fully addressed in a later phase of this proceeding. Parties should be fully prepared to discuss the issue during that phase."

5. The second sentence of the second full paragraph on page 38 is modified to read as follows:

> "However, we will not allow obstacles within our control to persist which thwart competition and open access between Canada and Northern California."

IT IS FURTHER ORDERED that rehearing of D.91-11-025 as modified herein is denied.

This order is effective today.

Dated February 10, 1992, San Francisco, California.

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

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

NEAL J. SHULMAN, Executive Director