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Decision 92-02-043 February 10, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

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 7, 1990)
And Related Matters	R.86-06-006 Application 91-06-035 Application 91-06-045 Application 91-06-056 Application 91-06-063

ORDER DENYING REHEARING OF DECISION 91-09-085

On September 27, 1991, the Commission issued Decision (D.) 90-09-089, which set forth new rules for utility gas procurement and transportation services. In addressing certain shortcomings of our then-existing regulatory program, the new rules provided for firm access to pipeline capacity on an interim basis and further limited the utilities' participation in noncore procurement markets. The new rules were adopted in recognition that our regulatory program required certain changes to ease the supply problems posed by pipeline capacity constraints.

Various parties filed applications for rehearing and petitions for modification of D.90-09-089, which we ruled on in several subsequent decisions, one of which was D.91-02-022. D.91-09-085, the subject of today's order, resolved additional petitions for modification of D.91-02-022, and, in addition, ruled on other related filings.

Applications for rehearing of D.91-09-085 have been filed by Harbor Cogeneration Company jointly with Kern River Cogeneration Company, Midway-Sunset Cogeneration Company, and Sycamore Cogeneration Company (Harbor); Sunlaw Cogeneration Partners I and AES Placerita, Inc. (Sunlaw);[1] and Southern California Gas Company (SoCalGas). We have reviewed each and every allegation of error raised by Harbor and Sunlaw, and are of the view that sufficient grounds for rehearing have not been shown. However, we will clarify the basis for our decision in the discussion which follows. We do not rule today on the application for rehearing filed by SoCalGas. We will issue a subsequent order on that application.

The issue plaguing Harbor and Sunlaw is our treatment of cogeneration priority in the context of cogeneration customers holding long-term contracts. In D.90-09-089, in response to the changed circumstances imposed by significant capacity constraints, we adopted rules which set up a system of service levels and end-use priorities such that within each noncore service level, price paid for transportation was the basic determinant of service priority.

Under those rules, long-term contract customers were deemed specifically to be entitled to opt for Service Level 3, the highest noncore interruptible service, at their discounted contract rates. If they wanted greater service reliability, they would have to pay an additional surcharge. In addition, in terms of curtailment priority for noncore customers, D.91-02-022 modified

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1. 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 new capacity brokering rules, in applications for rehearing filed by the following similarly situated parties: Sunlaw (jointly with AES Placerita, Inc., Destec Energy, Inc., and Berry Petroleum Company) and Cogenerators of Southern California. We resolve those applications today in D.92-02-042.

D.90-09-089 by clarifying that for those customers paying the same price within a service level, curtailment was to be determined based on end-use priorities (Service Level 3), or on a pro rata basis but with UEG customers always being curtailed before cogeneration customers (Service Levels 4 and 5).

Several cogenerators, including Sunlaw, petitioned for modification of D.91-02-022. They requested a clarification that for long-term contract customers, curtailments in Service Level 3 would be based on the percentage these customers paid of the default rate, rather than the actual price paid. We granted this request. Sunlaw also requested that we clarify that long-term contract customers be curtailed as if they were paying the full default rate rather than their discounted contract rates. We denied this request, in essence because it conflicted with the basic curtailment priority rules we had established in D.90-09-089.

In their applications for rehearing of D.91-09-085, Harbor and Sunlaw both allege that we have impermissibly interfered with their long-term contract rights, in contravention of the Commission's own precedent. Sunlaw contends, in addition, that we have violated the "basic constitutional principles prohibiting the impairment of contracts." Sunlaw has not, however, cited any case or other authority to support its argument that the type of regulatory action taken by us in D.90-09-089 and clarified in D.91-09-085 is an impermissible infringement of contract rights.

Sunlaw and CSC contend that while we stated in D.90-09-089 that we intend to honor existing long-term contracts, D.91-09-085 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 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 contracts" - the service provided for the rate paid.

These applicants, in recounting the history of our position with regard to long-term contracts, cite D.86-12-009 for the proposition that we 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 our 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 maintains that the Commission has an obligation to abide by its assurances because of the basic constitutional principles referred to above.

We note that while Harbor and Sunlaw 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) during at least the next several years. 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 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.

> "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." (In re Rate Design for Unbundled Gas Utility Services (1986) 22 C.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." (Re Gas Utility Procurement Practices and Refinements to the Regulatory Framework for Gas Utilities (1990) 37 C.P.U.C. 2d at p. 613.

We reiterate, as we do in D.92-02-042 (also issued today), that it is not and has not been our intention in adopting our gas transportation 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.

Our gas transportation 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 are now 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. 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 are not persuaded that the distinction they point out is significant. 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 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. As we have stated in D.91-11-025 with regard to our capacity brokering rules, 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. It would be inconsistent with our regulatory goals and discriminatory toward other noncore customers to deem their discounted contract rates to be equal to the default rate. Our transportation rules 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 more equitably 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. Therefore, we will deny their applications.

Harbor requests that the resolution of the curtailment priority issue here not be construed as prejudgement of this issue for our capacity brokering rules. As it happens, we have adopted the same policy for those rules, as we discuss in D.91-11-025 and D.92-02-042. We did not, however, prejudge this outcome. As Harbor notes, the issue was fully litigated in our capacity brokering hearings. For the reasons stated herein and in D.92-02-042, the outcome is fully consistent with the dictates of the market and with our own regulatory goals.

IT IS ORDERED that rehearing of D.91-09-085 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