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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA GAS COMPANY and PACIFIC LIGHTING GAS SUPPLY COMPANY to Increase Revenue Under the Consolidated Adjustment Mechanism to Offset Changed Gas Costs Resulting From Increases in the Price of Natural Gas Purchased from EL PASO NATURAL GAS COMPANY, TRANSWESTERN PIPELINE COMPANY, PACIFIC INTERSTATE TRANSMISSION COMPANY, and California sources; and to Adjust Revenues to Recover the Undercollection in the CAM Balancing Account.	Application 82-09-12 (Filed September 8, 1982)

(See Decision 82-12-047 for appearances.)

THIRD INTERIM OPINION

I. Introduction

This opinion covers the reasonableness of Southern California Gas Company's (SoCal) and Pacific Lighting Gas Supply Company's (PLGS) purchased gas costs for the period October 1, 1981 through June 30, 1982. Both companies are collectively referred to as SoCal.

The first two phases of this proceeding dealt with revenue requirements and rate design. The Commission issued Decision (D.) 82-10-040 and D.82-12-047 related to these issues.

This phase examines the reasonableness of SoCal's purchased gas costs which are recovered through the Consolidated Adjustment Mechanism (CAM) procedure.

Two days of evidentiary hearing were held in San Francisco on November 8 and 9, 1982. Robert Hohne and Earl Takemura testified for SoCal. Donald King testified for the Commission staff (staff). No other party presented testimony. This phase was submitted subject to opening briefs mailed December 17, 1982 and reply briefs mailed January 19, 1983. Opening and reply briefs were submitted by SoCal, staff, and Toward Utility Rate Normalization (TURN).

The staff witness testified that his "overall conclusion is that SoCal's purchase practices during the review period achieved a least-cost supply mix within contractual, regulatory and physical constraints." (Exhibit 61, 1-DLK.) SoCal's witnesses concluded that SoCal "prudently managed their gas supplies to maximize purchases of lower cost gas within contractual obligations and operating requirements." (Exhibit 29, page 46.)

However, staff counsel and TURN argue that SoCal's purchase and storage practices during the review period were not reasonable. They allege that: (1) SoCal was imprudent in extending for a short period a contract with Pacific Gas and Electric Company (PG&E) and (2) SoCal was imprudent for not acting in a timely manner in seeking an alternate transportation route for gas from Pan-Alberta Ltd. (Pan-Alberta). According to staff counsel and TURN, SoCal's lack of timeliness resulted in a capacity constraint problem which caused rejection of cheaper El Paso Natural Gas Company (El Paso) gas for more expensive Pan-Alberta gas.

We find that the evidentiary record cannot support the findings and conclusions of imprudence that staff counsel and TURN would have us make in connection with the PG&E contract extension and the capacity constraint problem. Based on circumstances existing at the time, we conclude that SoCal's gas purchases for the review period were reasonable.

II. Burden of Proof

SoCal points out that it was only after opening briefs were submitted that for the first time in this proceeding it was faced with allegations of imprudence. SoCal argues that since neither staff counsel nor TURN presented any witness or evidence to support their proposals, SoCal had thus been denied the opportunity to expose the allegations as baseless through the rigors of cross-examination.

SoCal's argument has no real substance. SoCal is well aware that reasonableness proceedings do not commence with a formal allegation that the utility has been imprudent with respect to a specific gas purchase. Since SoCal is the sole party in possession of evidence concerning the prudency of its past actions, it has to make a clear and convincing showing to demonstrate that its gas purchases for the review period were reasonable. Failure to meet this standard will result in disallowance.

It is a fundamental principle that the burden is on the utility to prove that the rates which it seeks are reasonable and not upon the Commission, the staff, or any other party to prove the contrary (In re Suburban Water Co. (1963) 60 CPUC 786 rev. denied; In re SoCal Gas Co. (1960) 58 CPUC 57).

When we initiated the annual reasonableness review procedure, we addressed the issue of the burden of proof as follows:

> "Of course, the burden of proof is on the utility applicant to establish the reasonableness of energy expenses sought to be recovered through ECAC. We expect a substantial affirmative showing by each utility with percipient witnesses in support of all elements of its application, including fuel costs and plant reliability." (D.92496, 4 CPUC 2d 693, 701.) (Emphasis added.)

The same requirements apply to the annual reasonableness procedures for gas and electric utilities.

D.92496 required a substantial affirmative showing. We have since had instances where a utility failed to completely justify the reasonableness of fuel-related expenditures, which we consequently disallowed to the dismay of the utility. It seems that further clarification of the burden of proof is required. Accordingly, we reiterate that the failure to make a showing with clear and convincing evidence is reason for disallowance of fuel-related expenditures reflected in balancing accounts.

For our purposes, the utility must fully explain with clear and convincing evidence what was done and why, so that we can evaluate whether the decisions were prudent under the circumstances, before passing such costs onto the ratepayer.

We realize that in reasonableness review proceedings, the early identification of issues is sometimes a problem. Although it is customary for the staff or others, such as TURN, to argue against portions of the utility's showing or even to put on their own showings on certain issues, there is no requirement in law that they do so and it cannot be said that SoCal's burden of proof on the issue of the reasonableness of rates or costs is lessened by the simple fact that other parties do or do not participate in the proceeding.

On the other hand, we agree that the hearing process will be more effective if issues are identified at the outset. Nevertheless, whenever parties raise or identify issues through cross-examination, the utility should have the analysis at hand and be able to respond.

SoCal argues that neither staff counsel nor TURN address the standard under which SoCal's actions are to be considered. Instead, SoCal contends staff counsel and TURN merely look at events after their occurrence and using hindsight, speculate on various scenarios to allege imprudence.

We realize the decision-making process in making a gas purchase or contract is complex. We also realize that reasonableness does not require perfect foresight. We only require that SoCal make prudent decisions based on the information available at the time. As we stated in D.82-09-105, mimeo. p. 7, SoCal is not subjected to arbitrary judgment by hindsight. However, SoCal is required to make a clear and convincing showing that its gas purchases were reasonable, otherwise these costs will be disallowed.

III. PG&E Contract Extension

The issue is whether it was reasonable for SoCal to have extended its contract with PG&E for firm gas when, as it turned out, SoCal would not have purchased any of this gas had not the contract extension required it to do so.

In December 1978 SoCal entered into a gas purchase agreement with PG&E, under which SoCal agreed to buy an average of 75 million cubic feet (MMcf) per day of natural gas on a firm basis. The contract also provided for additional deliveries of 75 MMcf per day on a best-efforts basis, at the discretion of both parties. The agreement was approved by this Commission on December 19, 1978 in Resolution G-2259. The contract was to expire as of December 31, 1981. On December 23, 1981, SoCal extended this contract.

The relevant events pertaining to the contract extension are summarized in SoCal's report (Exhibit 29, page 39):

> "Negotiations for a new purchase agreement with PG&E began in October, 1981, and continued into 1982. An indefinite extension of the existing agreement was executed on December 23, 1981. As the negotiations continued into 1982, the Utilities (SoCal and PLGS) attempted to negotiate a 'best efforts' only purchase obligation retroactive to January 1, 1982. As it became evident that this effective date could not be obtained, the Utilities cancelled the extension of the existing contract effective February 7, 1982. Beginning February 4, 1982, the Utilities took only the firm requirement equivalent of 75 MMcfd to

> fulfull the obligation incurred during January 1 - February 6, 1982. No PG&E gas was taken after the obligation was satisfied. The Utilities agreed to a new contract with PG&E which provides for purchase of up to 150 MMcfd on an 'all discretionary' basis. The contract dated March 26, 1982, becomes effective upon approval by the CPUC."

The contract extension lasted for 38 days in January and February 1982, while negotiations continued for a new "all discretionary" contract.

Staff counsel and TURN argue that by extending the PG&E contract with its firm obligation of 75 MMcf per day, SoCal acted imprudently and incurred unnecessary additional gas costs of $3,641,000. They recommend that these costs be disallowed from SoCal's CAM balancing account.

SoCal agrees that as events turned out, the contract extension was not needed. However, it is SoCal's position that at the time the contract was extended a real and immediate possibility existed that the gas would be needed to meet operating requirements. According to SoCal, it took this reasonable, prudent course in order to protect its high priority customers. SoCal's witness Hohne offered the following rationale for the contract extension:

> "Obviously December at the end of the year is right in the middle of the start of the winter season, and the PG&E contract had provided us a very secure source of supply for a number of years and we were coming on to the cold weather.
>
> "And we thought it would be prudent to extend that contract. Now, at the time we agreed to extend it, we also thought we would be able to negotiate with PG&E to make it totally discretionary -- not only totally discretionary during the year, but also effective January 1, 1982." (Tr. 2155.)

According to SoCal, even though supplies from its primary gas suppliers may have been "adequate" in the fall of 1981, this did not mean that SoCal could rely upon the level of those volumes continuing during the winter when supplies often are reduced. SoCal asserts that the daily volumes of gas from El Paso and Transwestern change dramatically depending upon several factors such as weather in the producing area, loss of "best efforts" interstate and intrastate supplies and greater demand from other customers of these suppliers. (Exhibit 29, pg. 1, 2).

SoCal notes that one of its primary operating objectives is to have, at a minimum, adequate supply to meet the Priority One through Priority Four (P1-P4)[1] gas requirements in a cold year. (Exhibit 29, page 46.) SoCal further notes that the Commission has not rescinded this operating objective.

We note that about four months prior to the date of the PG&E contract extension, the Commission stated in D.93368 dated August 4, 1981, mimeo, page 41, in OII 79 related to SoCal's exploration and development programs: "So, our goal is to protect gas deliveries to Priorities 1-4 in a <u>cold year</u>, and to the extent gas is available to Priority 5[2] demand so much the better." (Emphasis added.)

SoCal submits that evidence in the record indicates that without the PG&E gas, if SoCal's service area had experienced a cold winter, SoCal would have been unable to serve all of the P1-P4 market in January 1982 from its primary supply with the normal use of storage. SoCal points out that the PG&E contract would have provided up to 150 MMcf per day of gas to serve this market.

SoCal further points out that the P1-P4 cold year requirements forecast for January was 110 Bcf or 3,569 MMcf per day.

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[1] Includes all customers except utility electric generation.

[2] Utility electric generation.

(Exhibit 29, page 17.) Total primary supply, excluding PG&E gas, was forecasted in the record to be 2,495 MMcf per day. (Exhibit 29, page 35.) Projected storage withdrawals during January were 20.5 Bcf or 661 MMcf per day. (Exhibit 29, page 44.) Thus, only 3,156 MMcf per day of primary supply was projected to be available, absent the PG&E contract, to serve the P1-P4 cold weather January requirements of 3,569 MMcf per day. According to SoCal, the resulting 413 MMcf per day shortfall could therefore have been supplied in part by the PG&E gas under the contract extension.

We note, with some concern, that the above analysis was first presented by SoCal in its reply brief. We see no reason why this analysis was not presented as part of SoCal's direct showing as part of its burden of proof on the prudency of its purchases.

Returning to staff counsel and TURN's allegations, we note that when SoCal extended the contract with PG&E, its supply and demand balance was certainly no cause for concern. From the beginning of October until late December, when the PG&E contract was extended, El Paso and Transwestern were offering full volumes. SoCal, however, to take contractual minimum quantities of Pan-Alberta gas, was having to turn back El Paso gas. California sources were also above their forecasted supply levels.

On the other hand, despite the adequate supplies available until late December, we have to agree with SoCal that there was a theoretical shortfall in SoCal's primary supplies if P1-P4 customers had to be served in a "cold year". (SoCal's forecasts are based on three scenarios: a warm year, average year, and cold year.) SoCal agrees that under the cold year scenario, it could have supplied P1-P4 customers during January 1982 by drawing down storage below normal levels for the time of year. However, SoCal argues that:

> "While storage could have been used to supply this market in January, 1982, without the PGandE gas, to do so would leave storage at a

> dangerously low level in the event of additional cold weather later in the winter of 1982. The PGandE gas substantially reduced this potential danger and at a price previously approved by the Commission." (Emphasis added.)

Staff counsel and TURN contend that if SoCal had encountered unforeseen supply difficulties later in the winter, SoCal could have obtained gas from PG&E with no contract, if gas was available, under the SoCal-PG&E Mutual Assistance Agreement (Agreement).

The argument of staff counsel and TURN is misplaced. The Agreement was entered into at the direction of the Commission in D.89177 issued July 31, 1978, for the protection of P1-P4 customers and was approved by the Commission in Resolution G-2274 issued May 8, 1979. The Agreement is available only for emergency conditions. Under the Agreement, either party must first exhaust all other available supplies before calling on the other party for supplies under the Agreement. Therefore, SoCal would have been obligated to first take all discretionary Pan-Alberta gas, all available Michigan Consolidated Gas Company (Mich-Con) gas, and all available Northwest Pipeline Company gas before being able to call upon any PG&E gas under the Agreement. Thus, if there had been a cold winter, and SoCal ran into unforeseen supply difficulties, the course of action advocated by staff counsel and TURN would have resulted in significantly higher costs to SoCal customers.

In passing, we note that in D.82-04-116, mimeo. p. 72 , we directed SoCal to purchase PG&E best-efforts gas before Mich-Con gas as long as the cost differential is less than .5¢/th. We found that there is a public interest in SoCal purchasing additional supplies of PG&E gas before it turns to out-of-state supplies of Mich-Con gas.

Since we stated that our goal was to protect gas deliveries to P1-P4 customers in a cold year, we cannot fault SoCal for scheduling supply and inventory targets to maximize service to P1-P4 customers in a cold year. The PG&E contract was extended three months after we announced this objective. The record shows that there was a theoretical shortfall of primary supply for the period in question. Therefore, we conclude it was reasonable for SoCal to make up this shortfall by extending the PG&E contract. Accordingly, we reject staff counsel and TURN's recommendation of a disallowance.

We now turn to staff counsel and TURN's allegation that SoCal refused to take minimum quantities of PG&E gas in January - during a period when either it could have been sold to its P5 market or used to fill storage to the target level - and then in February became obligated to take the gas when there was no P5 market for it and storage was above target. As a result, according to staff counsel and TURN, SoCal turned back cheaper El Paso gas which would have saved the ratepayer $3,641,050.

SoCal's perception of its market in January and February 1982 provides a useful background:

> "During January and February curtailment of primary supply by El Paso and Transwestern and payback of RP 76-38* gas caused the Utilities to reduce storage inventories more than 5 Bcf below the target for January 1982 month-end to meet customer demand. This operation caused no problem in meeting peak winter demands.
>
> "During the review period, P5 customers reduced natural gas consumption for several reasons. Among them were the price differential in favor of fuel-oil, contractual obligations with oil suppliers, availability of hydroelectric power, availability of lower cost purchased power and various tests on oil firing.
>
> "P1-P4 deliveries were also considerably below the Utilities' forecast for an average temperature year. A large portion of the

> forecast steamflood market did not materialize. This was probably due to the price decline for heavy crude and the rising cost of natural gas. The ammonia producing market was also less than forecast. Residential usage was less than forecast due to warmer than normal temperatures.
>
> "Consequently, even though storage was below target at the end of January, 1982, and all available market was served during most of January, 1982 and every day from January 26 through June 30, 1982, the Utilities were unable to maintain their underground storage drawdown schedule and ended the review period about 31 Bcf above the average temperature year estimate as shown in Figure 4-1 and Table 4-2. As the market continued to soften, the Utilities were forced to commence storage injections early and turn back Transwestern and El Paso volumes.
>
> > "*El Paso's permanent allocation plan, approved by the FERC in May, 1981, requires the Utilities (SoCal and PLGS) to 'refund' a total of 32.69 Bcf over a four-year period to PGandE and East-of-California customers." (Exhibit 29, page 39.)

SoCal's explanation for not taking the PG&E gas in January 1982 is that operating conditions that month did not require taking the gas although storage was slightly below target.

According to Hohne, SoCal had hoped that PG&E would eventually sign a best efforts contract and make it retroactive to January 1, 1982, and thus, allow SoCal "to have access to a very significant source of supply, and yet not obligate us to take that supply." Therefore, Hohne contends it was reasonable for SoCal to defer taking the PG&E gas in January since there was an expectation that SoCal would be relieved of the contractual obligation to take the gas.

Staff counsel and TURN argue that the problem with Hohne's reasoning is that it was based upon either naive or foolish optimism that PG&E would let SoCal out of its prior contract obligations when the new contract was signed.

We share some of staff counsel's and TURN's concerns. However, we note Hohne was not directly involved in the contract extension. This does not excuse SoCal from the requirement of providing a percipient witness. SoCal would be well advised to present witnesses directly involved in such matters; otherwise it will run the risk of disallowance for failure to sustain its burden of proof.

We will now examine the consequences of SoCal not taking the PG&E gas in January and then taking it in February "when there was no P5 market for it and storage was above target."

Review of SoCal's operating records, Exhibit 29 as supplemented by SoCal's letter dated December 7, 1982, shows that in January 1982, P5 customers refused gas on 21 days. Therefore we have to agree with SoCal that operating conditions did not require taking PG&E gas in January.

On the other hand, we should examine SoCal's operations for January on the basis that SoCal incurred the PG&E contract obligation and "should have taken the PG&E gas in January when it had a market."

Under the contract extension, SoCal acquired a firm supply of 75 MMcfd commencing January 1. This equates to 2.3 BCF for the month of January. It was not available in December 1981.

We note that the month of January started with underground storage 3.6 BCF above target (Exhibit 29, Table 4-2). Commencing the 2nd of January there was significant withdrawal of gas, averaging over 1 BCF per day, to meet demand (Appendix A-4). These withdrawals continued through most of the month. If this rate of withdrawal had not been reduced by curtailment of P5 customers, underground storage at the end of the month should have been 12.6 BCF below target instead of 5.6 BCF below target. (Curtailment of P5 was 7 BCF, letter December 7, 1982). 12.6 BCF below target is a significant shortfall, therefore, we find it was reasonable for SoCal to curtail P5 customers to reduce storage shortfall.

Another factor which does not support the sale of PG&E gas to P5 customers in January, is the reductions of El Paso and Transwestern supplies. These supplies dropped significantly about the middle of January. (Exhibit 29, Appendix A-4).

The total PG&E supply for the month equates to a little over 2 days withdrawal from storage. Therefore if SoCal took 2.3 BCF of PG&E gas in January, it would not have significantly changed the need to curtail. Underground storage would still have ended below target. Since there are valid reasons for achieving underground storage targets (Exhibit 29), particularly in January which is in the middle of the winter season, we cannot fault SoCal for not selling the PG&E gas in January. We conclude that under normal underground storage operating procedure, even if SoCal had taken delivery of the PG&E gas in January, it would have been used to supplement storage rather than for sale to P5 customers. We find no basis to conclude that SoCal should have turned around and sold this gas to the P5 customers in January even if the gas was taken from PG&E in accordance with the contract obligation.

Turning to the operating records for February, we note that commencing February 4, 1982, when SoCal started taking PG&E gas to discharge its contractual obligation, deliveries from El Paso and Transwestern were below capacity. Therefore, this was as good a time as any for SoCal to satisfy its obligation to take the PG&E gas. Also, we note that commencing February 11, while SoCal was taking PG&E gas, there was refusal of less expensive El Paso gas, but this was necessary to take the Pan-Alberta minimum contractual obligation. Accordingly, we conclude that SoCal's operations in February were reasonable.

Staff counsel and TURN argue that absent the purchase of PG&E gas in February, SoCal could have purchased equivalent volumes of less expensive El Paso gas later in the year. This argument has no merit. The operating records show that P5 customers refused gas on every day in February through June 1982. As we see it, there is no basis to conclude that SoCal could have sold more El Paso gas later in the year.

Finally, we note that staff witness King testified that SoCal's purchase of the PG&E gas in February "probably worked out in the best fashion it could have worked out" from a total cost standpoint. King stated "If Southern California Gas Company had not taken the hundred and fifty million cubic feet on a number of days in February, PG&E would have been in a position of backing out either more California gas to the extent they could physically do so or El Paso gas." The benefit to PG&E's customers is incidental to our assessment of SoCal's actions.

We share staff counsel and TURN's concern that SoCal was not better able to forecast the gas market for January and February 1982. However, SoCal reminds us that unlike a combination utility, it is not affiliated with its electric generation customers. According to SoCal this circumstance adds considerable complexity to its system operations and substantially adds to the uncertainty of gas demand as compared to combination utilities such as PG&E and San Diego Gas & Electric Company.

Although we cannot fault SoCal for following Commission objectives, it does appear that SoCal acted mechanically in extending the PG&E contract in order to have protection under a worst case scenario. Nowhere in the testimony did SoCal indicate that an economic evaluation was made of the downside risk of going into the winter without the extension to the PG&E contract. Rather, it seems that SoCal was content to follow a policy of having ample firm supply at all times to serve the P1-P4 market without questioning the need.

IV. Pipeline Capacity Problem

TURN alleges that SoCal should have more timely secured a second delivery point for its Pan-Alberta supply and thereby avoided rejecting less expensive El Paso gas on most days from October 1, 1981 through April 8, 1982. According to TURN, the problem occurred on the days when El Paso was delivering full contract quantities to both SoCal and PG&E, and at the same time Pan-Alberta contract daily minimum quantities had to be transported. The El Paso rejections that TURN refers to equal the daily minimum Pan-Alberta contractual obligation of 84 MMcf per day for the period.

According to TURN, SoCal had two options had the second delivery point been available on October 1, 1981: SoCal could have purchased additional El Paso gas and then sold additional supply to its P5 customers, or SoCal could have reduced its purchases of the more expensive PG&E and Transwestern gas. TURN calculates the resulting loss from SoCal having failed to have the second delivery point as $11,703,000 or $5,084,000, depending upon which scenario was possible during the period. TURN leaves it to the Commission to decide which scenario is more plausible.

The "reasonableness" question facing this Commission is whether SoCal should reasonably have anticipated the possibility of capacity constraints and acted earlier to obtain FERC approval of a second delivery point to avoid rejection of less expensive El Paso gas.

The primary routing for delivery of Pan-Alberta gas to SoCal from Canada is through the so-called Western Delivery System (WDS). The gas enters the United States and flows through the Pacific Gas Transmission (PGT) system to Stanfield, Oregon, where it is transferred to Northwest Pipeline Company (Northwest). Northwest then transports the gas through its system to the point of interconnection with El Paso (in reality this transaction occurs through displacement). El Paso delivers the supply through its main line to SoCal's system at the California border.

The second delivery point, which is now in operation, permits receipt of the Pan-Alberta volumes through the PGT-PG&E

system when that system has excess capacity and when the El Paso system has insufficient capacity to carry full El Paso volumes and minimum Pan-Alberta volumes at the same time. Thus, with the second delivery point, SoCal is now able to maximize the receipt of El Paso gas while still fulfilling its obligation to take Pan-Alberta gas.

SoCal contends it acted in a timely manner to secure the second delivery point. TURN disputes SoCal's claim and alleges that proper planning and foresight by SoCal could have avoided the rejection.

TURN argues that SoCal should have sought the second delivery point earlier because of: language in a petition for rehearing filed with the FERC by the Commission and information on forecasted supply contained in El Paso's FERC Form No. 16.

TURN notes that the potential for capacity constraints in the WDS was identified as a problem in the FERC certification proceeding. The Commission's petition for rehearing filed May 7, 1980, in Docket No. CP 78-123, et al., contained the following argument:

> Additional adverse economic impacts could result because of the proposed routing, which has the potential to cause a loss of substantially less expensive domestic supplies in order to deliver WDS volumes to facilities of limited capacity on the SoCal system. (Petition, page 4.)

TURN contends that SoCal ignored this warning for well over a year before beginning the process of securing a second delivery point. According to TURN that period could have been used to secure the necessary contracts and regulatory approvals. TURN argues that it would seem that prudent and cautious utility managers would undertake every effort to prevent problems such as this one, even if the risk appeared relatively small.

SoCal points out that the one sentence in the entire petition for rehearing that TURN relies upon is merely an unsupported statement that limited capacity on the SoCal system could have some unspecified adverse impact. According to SoCal the evidence at the time of the FERC hearings indicated that there was no capacity problem. The statement in question was not supported by any analysis.

We concede that the sentence in question was prophetic; however, it does appear that FERC considered it unsubstantiated argument and chose not to act on it. In the absence of something more concrete, we are not prepared to find SoCal imprudent on this ground alone.

SoCal notes that when the Pan-Alberta contracts were entered into and when the project was approved by the FERC, sufficient capacity was forecasted to exist for full delivery of Pan-Alberta gas without a turnback of El Paso gas. Some time after June 30, 1981, El Paso informed Pacific Interstate (SoCal's affiliate) that a capacity constraint could exist on the El Paso system. According to SoCal, before this time El Paso was assuring Pacific Interstate that capacity existed, and El Paso was also reporting to the FERC in its Form No. 16 filing that capacity existed.

Because of these assurances SoCal submits it had no reason to believe that a capacity problem would occur. SoCal maintains it was entitled to rely upon El Paso's continued assurances and that such reliance was entirely reasonable. SoCal further argues that if capacity did not exist, El Paso was disadvantaged because it was the El Paso gas which was turned back. Because of this, SoCal contends it was rational to believe that if there was any reasonable possibility of insufficient capacity, El Paso would not have been giving assurances of sufficient capacity.

In this context, SoCal witness Hohne's assessment of the need to have initiated earlier negotiations for a second delivery point is set forth:

> "Q Do you know any reason why the company would not begin discussions with PGT prior to August -- I mean, say, in April, just on the chance that there might a problem with the capacity problem, given the forecast El Paso was making?
>
> "A I think that is the reason, they didn't feel it was a problem, Mr. Rosenberg.
>
> "Q So in your mind the company's view was that the probability of there being any turnback in October back in April was so remote that it wasn't worth even the effort of some preliminary negotiations of PGT about an alternative routing in case there was a problem?
>
> "A Yes." (Tr. 2058.)

We now turn to SoCal's assertion that it was not until about June 30, 1981 that it became known that a real problem existed.

We note that none of the communications with El Paso regarding the problem were reduced to writing. According to Hohne, the communications consisted of telephone conversations between Harry Lepape of Pacific Interstate and unnamed officials at El Paso. Lepape did not testify in this proceeding. We warn SoCal that in situations such as this, where there is a possible conflict of interest, we will not give SoCal the benefit of the doubt unless there is supporting documentary evidence to show that SoCal was diligently looking after the interests of its ratepayers. SoCal's executives should take a more agressive posture when dealing with corporate affiliates. It is time for SoCal to closely examine its relationship with other corporate affiliates to make sure it is fulfilling its utility obligations.

SoCal contends that the negotiations for new transportation agreements began as soon as practical after notification by El Paso of possible capacity constraints. The agreements were reached on an expedited basis, considering the complexity of completing all of the technical, legal, and policy matters relating to the new transportation system. Transportation agreements were completed between Pacific Interstate and PGT on August 18, 1981, and between SoCal and PG&E on October 9, 1981. The application to the FERC requesting approval for this alternative transportation system was filed with the FERC by Pacific Interstate on October 15, 1981. This was six days after the final transportation agreement was reached. The FERC order authorizing the alternative transportation route was issued March 12, 1982. Pacific Interstate accepted its certificate on March 29, 1982, 17 days after the FERC certificate was issued. (Exhibit 29, page 40.) According to SoCal the entire process of negotiations and regulatory authorization for the second delivery point proceeded remarkably fast.

We will now move on to TURN's allegation that SoCal should have had notice of a capacity constraint from El Paso's FERC Form No. 16.

El Paso is required to file semiannually on April 30 and September 30, a report of gas supply and requirements designated as FERC Form No. 16. The April filing indicates that pipeline capacity existed to transport the El Paso forecast and the Pan-Alberta minimum of 84 MMcf per day for all months except October 1981, when there was a capacity shortfall on the El Paso/SoCal system of 8 MMcf per day.

TURN argues that: "Since the minimum daily Pan Alberta obligation was 84 MMcf, it seems odd that this forecast would have been considered comforting by So Cal. It is possible to utilize spare capacity on the PG&E system when El Paso is delivering less than full volumes, but the range of tolerance was certainly very small."

We note that TURN concedes there was spare capacity on the PG&E system. We also note that the problem occurred because as it turned out, El Paso deliveries in October and the months following exceeded the Form No. 16 forecast. It so happened that the pipelines were full and "no range of tolerance" remained. El Paso gas had to be turned back in order to take the Pan-Alberta contract minimum obligation.

TURN questions whether SoCal should not have anticipated that El Paso's deliveries in October and the following months would exceed the Form No. 16 forecast particularly "since the passage of the Natural Gas Policy Act (NGPA), El Paso's forecasts have generaly been on the low side."

On cross-examination Hohne offered the following testimony:

"Q In your experience over the past five years with El Paso forecasts, isn't it the case that El Paso had consistently underestimatd its supplies available to SoCal?

"A Well, on balance that may be correct, but at this time in June, I don't know what the problem was. But they were forecasting very high deliveries to us for gas and they were not meeting those deliveries.

"Q They were not meeting those deliveries at what point?

"A They didn't meet those deliveries at all during the summer. As a matter of fact, they didn't meet their forecast until the first day of October when the Pan Alberta gas began to flow."

Staff witness King's observations on El Paso's forecasts are as follows:

"Q With regard to El Paso's forecasts of its gas supply available to SoCal, has there been a pattern in the period subsequent to passage of NGPA of those forecasts being low?

"A Yes. I think that's the general case, and there's a good reason for that. El Paso is a very complicated system. It is able to estimate with a high degree of accuracy the deliverability from its dedicated supplies.

"But it's very difficult to know on a day-to-day basis or on a monthly basis into the future how much excess discretionary gas will be available from short term suppliers.

"Given that situation, El Paso or any other supplier would tend to -- or I would say rather be on the short side than to tell a customer we're going to have more gas available than actually materializes.

"So, in a general case, El Paso, I think, tends to understate -- has tended to understate the volumes of gas to be available over short term future periods."

On recross, Hohne offered the following explanation:

"Q All right. Now, if we would add the minimum take from the Pan Alberta contract of, what, 84 to 86 million cubic feet a day, that would put you over the pipeline capacity?

"A That would put us over in our system, Mr. Rosenberg, but El Paso was less than full contract and there would be less to PG&E.

"There would be capacity in PG&E's system. That kind of capacity would be sufficient to move the minimum quantity of Pan Alberta gas.

"Q You have acknowledged though, with the exception of last summer, El Paso has for the past five years at least underestimated considerably in its supply forecast the volumes of gas delivered to Southern California?

"A I think what I said, Mr. Rosenberg, was that the enactment of the NGPA makes forecasting very, very difficult. And where we and El Paso and Transwestern and everybody else has trouble is forecasting the amount of their short-term nonfirm capacity supply.

"And El Paso has tended to be conservative in the forecast of supply available from that source.

"Q In fact during that period, there was considerable extra quantity of gas that El Paso had to fill up the pipeline despite its forecast of not meeting the pipeline capacity; is that right?

"The actual volumes that were offered to you were at pipeline capacity through all the winter, because you were turning it back virtually every day from October right on through March when you got the alternative delivery system?

"A That's right. And it is sort of strange that we were bumbling along in the summer at far less than capacity.

"Then almost immediately on October 1, El Paso was able to give us full deliveries, something we did not expect for that entire period."

SoCal argues that it is significant that in the summer of 1981, El Paso was delivering less than forecasted volumes because during the summer El Paso's deliveries are normally at their seasonal high. While we agree that El Paso deliveries were unusually low in the summer of 1981, and the NGPA made forecasting difficult, SoCal was aware of the possibility, however unexpected, that El Paso deliveries could exceed the forecast.

Putting ourselves in the shoes of the executives responsible for gas purchases, we conclude that SoCal's actions at the time were reasonable. Having the benefit of hindsight, we can now see that it would have been ideal if SoCal did have the second delivery point in time to avoid a turnback of less expensive El Paso gas. However, we have to put ourselves in the time frame of the summer of 1981: El Paso was delivering considerably less than contract quantities, when according to past experience deliveries should have been over forecast in the summer; the Form No. 16 filings showed no actual capacity shortfall; and according to SoCal, El Paso was providing assurance that there was no capacity problem. Also, we have to agree with SoCal that if a capacity problem was reasonably foreseeable, El Paso should have been the first to point that out since it was El Paso that would have been disadvantaged because its gas would have been rejected.

In summary, we conclude that it would have been ideal if a second delivery point was in place to avoid a turnback of less expensive gas. However, under the circumstances prevailing at the time, SoCal acted reasonably. We cannot expect perfect foresight from the utility at all times. Accordingly, we reject TURN's allegations of imprudence.

V. Pan-Alberta Purchase Requirements

Staff counsel and TURN expressed concern that SoCal was not aggressively pursuing reduction in the minimum purchase requirements contained in its Pan-Alberta contract. They point out that because of a reduced market, significant quantities of less expensive El Paso and Transwestern gas are being turned back because SoCal is compelled to take minimum contractual obligations of more expensive

Pan-Alberta gas. They recommend that the Commission pursue every available avenue to obtain a reduction in the Pan-Alberta contractual minimum obligation.

Since submission of this proceeding, SoCal informed the Commission that agreement in principle has been reached with its Canadian suppliers which would reduce its gas purchase obligation by more than $300 million over the next 18 months. This, in turn, would permit SoCal to buy less expensive replacement gas volumes currently available from domestic sources with a net savings of approximately $80 million for consumers over the next 18-month period.

Under a 1978 contract, which was approved by FERC, Pacific Interstate previously had to purchase a minimum of approximately 111 billion cubic feet (Bcf) of gas over the 18-month period. According to SoCal, this amount would be reduced by 61% to approximately 44 Bcf under the amended contract.

The anticipated contract amendment will require approval by the Canadian producers and governmental authorities. However, Pacific Interstate expects to reduce its Canadian gas purchases even prior to such approvals.

While we note that some progress has been achieved, SoCal must continue to aggressively seek additional reductions in the Canadian price of gas exported to the U.S. to bring that price down to a competitive level.

Findings of Fact

1. SoCal extended its firm gas supply contract with PG&E for 38 days in January and February 1982 and incurred the obligation to take 75 MMcf per day. As events turned out, the contract extension was not needed.

2. The Commission in D.93368 dated August 4, 1981 stated that one of its goals was to protect gas deliveries to P1-P4 in a cold

year. This goal had not been rescinded when the PG&E contract was extended.

3. There was a theoretical shortfall of 413 MMcf per day in SoCal's primary supplies for the 1981/82 winter based on a cold year scenario. This shortfall was reduced by the PG&E contract extension.

4. Based on information available at the time, February 1982 was as good a time as any for SoCal to satisfy its PG&E contractual obligation.

5. Because of pipeline constraints, on most days from October 1, 1981 through April 8, 1982, SoCal turned back quantities of less expensive El Paso gas in order to take its minimum contractual commitment of Pan Alberta gas.

6. In the FERC certification proceeding on the WDS, the Commission's petition for rehearing filed May 7, 1980, in Docket No. CP 78-123 et al., contained the following statement:

> Additional adverse economic impacts could result because of the proposed routing, which has the potential to cause a loss of substantially less expensive domestic supplies in order to deliver WDS volumes to facilities of limited capacity on the SoCal system. (Petition, page 4.)

This statement was not substantiated by any evidentiary showing.

7. At the time the Pan-Alberta contracts were entered into and when the WDS project was approved by FERC, sufficient capacity was forecasted to exist in the El Paso system for delivery of the Pan-Alberta gas without the need for turnback of El Paso gas.

8. SoCal contends that the first time that it had information that a capacity constraint problem existed was about June 30, 1981.

9. El Paso's Form No. 16 filed in April 1981 indicates a capacity shortfall in October of 8 MMcf per day on the El Paso/SoCal system, which shortfall could be made up on the El Paso/PG&E system. On this basis, there would have been no turnback of El Paso gas.

10. In the past, El Paso gas deliveries have generally been above forecasts.

11. The enactment of the NGPA makes forecasting short-term gas supplies difficult.

12. El Paso gas deliveries during the summer of 1981 were below forecast. El Paso returned to full pipeline quantities on October 1, 1981.

Conclusions of Law

1. The utility has the burden of proving by clear and convincing evidence that its expenditures are reasonable.

2. Since the Commission in D.93368 stated that its goal was to protect gas deliveries to P1-P4 customers in a cold year, it was prudent for SoCal to extend its PG&E contract to maximize service to P1-P4 customers in a cold year.

3. Based on information available at the time, it was reasonable for SoCal not to take PG&E gas in January and then to take PG&E gas in February 1982 in order to satisfy its contractual obligation.

4. Based on the information available at the time, SoCal was not imprudent in not securing a second delivery point to transport Pan Alberta gas prior to October 1, 1981.

THIRD INTERIM ORDER

IT IS ORDERED that no adjustment be made to Southern California Gas Company's Consolidated Adjustment Mechanism Balancing Account on account of reasonableness of gas purchases for the period October 1, 1981 through June 30, 1982.

This order becomes effective 30 days from today.

Dated OCT 5 1983, at San Francisco, California.

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

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

Joseph E. Bodovitz

Joseph E. Bodovitz, Executive Director

According to SoCal, even though supplies from its primary gas suppliers may have been "adequate" in the fall of 1981, this did not mean that SoCal could rely upon the level of those volumes continuing during the winter when supplies often are reduced. SoCal asserts that the daily volumes of gas from El Paso and Transwestern change dramatically depending upon several factors such as weather in the producing area, loss of "best efforts" interstate and intrastate supplies and greater demand from other customers of these suppliers. (Exhibit 29, pg. 1, 2).

SoCal notes that one of its primary operating objectives is to have, at a minimum, adequate supply to meet the Priority One through Priority Four (P1-P4)[1] gas requirements in a cold year. (Exhibit page 46.) SoCal further notes that the Commission has not rescinded this operating objective.

We note that about four months prior to the date of the PG&E contract extension, the Commission stated in D.93368 dated August 4, 1981, mimeo, page 41, in OII 79 related to SoCal's exploration and development programs: "So, our goal is to protect gas deliveries to Priorities 1-4 in a cold year, and to the extent gas is available to Priority 5[2] demand so much the better." (Emphasis added.)

SoCal submits that evidence in the record indicates that without the PG&E gas, if SoCal's service area had experienced a cold winter, SoCal would have been unable to serve all of the P1-P4 market in January 1982 from its primary supply with the normal use of storage. SoCal points out that the PG&E contract would have provided up to 150 MMcf per day of gas to serve this market.

SoCal further points out that the P1-P4 cold year requirements forecast for January was 110 Bcf or 3,569 MMcf per day.

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[1] Includes all customers except utility electric generation.

[2] Utility electric generation.

Putting ourselves in the shoes of the executives responsible for gas purchases, we conclude that SoCal's actions at the time were reasonable. Having the benefit of hindsight, we can now see that it would have been ideal if SoCal did have the second delivery point in time to avoid a turnback of less expensive El Paso gas. However, putting ourselves in the time frame of the summer of 1981: El Paso was delivering consideraly less than contract quantities, when according to past experience deliveries should have been over forecast in the summer; the Form No. 16 filings showed no capacity constraint; and according to SoCal, El Paso was providing assurance that there was no capacity problem. Also, we have to agree with SoCal that if a capacity problem was reasonably foreseeable, El Paso should have been the first to point that out since it was El Paso that would have been disadvantaged because its gas would have been rejected.

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4. Based on the information available at the time, SoCal acted prudently in not securing a second delivery point to transport Pan Alberta gas prior to October 1, 1981.