Decision 93370 AUG 4 1981

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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 for Authorization to Include Certain Purchase Gas Costs in the Approved PGA Procedures.	Application 59793 (Filed July 3, 1980)

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Randolph W. Deutsch and Richard Rosenberg, Attorneys at Law, for the Commission staff.

I N D E X

O P I N I O N

Summary

This application involves costs associated with importation into the United States of up to 240 MMcf/d of natural gas at the Canadian border. Approximately 215 MMcf/d will ultimately be delivered to Southern California Gas Company (SoCal) at the California/Arizona border. The sale and transportation of gas by Pan-Alberta Gas, Ltd. (Pan-Alberta) to SoCal is part of the prebuilding of the Alaskan Natural Gas Transportation System (ANGTS) and has been determined by the Federal Energy Regulatory Commission (FERC) to be in the national interest since it is a necessary component in the ultimate construction and operation of ANGTS.

The estimated cost of the Pan-Alberta gas delivered to the California border ranges as follows:

		Staff	
	SoCal	Full Formula	Discounted
	($1 MMBtu)		
1982	7.34	8.52	7.56
1983	8.11	8.33	7.29
1984	8.17	8.88	7.77
1985	8.99	9.47	8.28

The projected cost of the Pan-Alberta gas exceeds the estimated Priority 5 reference price (or the price of alternate fuel), at a minimum, during the first two years of the project and probably during the project's first five years. Furthermore, the availability of Pan-Alberta gas to the SoCal system is estimated to result primarily in increased deliveries to Priority 5 service over the initial five years of the project.

SoCal has requested authority to recover the costs associated with the Pan-Alberta project in its Purchased Gas Adjustment (PGA) mechanism. We agree that the PGA is the most

flexible, effective, and inexpensive method by which to monitor Pan-Alberta gas costs on the ratepayers' behalf. We will, therefore, grant SoCal's request. However, in view of the relatively high delivered cost of the gas and its projected predominant use by Priority 5 customers, we find it necessary to address two further issues:

1. Management's criteria for determining the prudency of long-term gas supply purchases, and
2. Rate design implications of the Pan-Alberta project gas.

With respect to long-term gas supply planning, the Commission, in Decision (D.) 89177, indicated its support for a policy favoring utility acquisition of maximum available quantities of gas and corresponding reduction of dependence on imported oil. In accordance with that policy statement, SoCal management has focused on the "need for gas" as its predominant criterion in determining whether development of a particular long-term gas supply project is prudent. The company's basic acquisition policy seeks to obtain enough supply to meet Priority 1 through 4 demands under all temperature conditions.

While SoCal cannot be faulted for following enunciated Commission policy, the escalating costs of gas supply projects now preclude the Commission from simply accepting a "gas at any cost" philosophy as a utility procurement policy. An economic test must be established to assist the utility and the Commission in determining whether development of a new supply source is in the public interest.

Two alternative tests appear viable. The first test considers whether the net cost of the gas supply at the California border exceeds the price of imported crude to petroleum refiners in California over the life of the project. If the price of the gas supply at the California border exceeds the cost of feedstocks used in the production of alternative fuels, then the gas supply should not be acquired unless other relevant factors outweigh the economics of the project. The second test considers whether the net cost of the gas supply at the California border exceeds the price of alternative fuels displaced by importation of the natural gas over the life of the project.

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We will reserve judgment on which economic test is preferable until analysis of their respective merits has been made in SoCal's next PGA proceeding.

With respect to the issue of the rate design implications of the Pan-Alberta project, much relevant evidence was produced concerning which class or classes of customers will benefit from the addition of Pan-Alberta supplies and the extent to which each class of customers will bear the prebuild project costs under current Commission rate design guidelines. With this information, a rate design can be implemented which will more equitably relate the actual costs incurred by a class or classes of customers with the actual benefits received as a result of the Pan-Alberta additions.

However, we do not make specific rate design findings in this decision. Actual rate design treatment for the costs associated with the prebuild project are more appropriately addressed in SoCal's next PGA filing. We will, however, incorporate by reference into that proceeding the relevant portions of this record.

Background

D.83160, issued in Application (A.) 53797, authorized establishment by SoCal of its PGA procedure. In approving SoCal's PGA, the Commission directed SoCal to seek specific authorization for inclusion in the PGA of costs incurred in obtaining large increments of new supply. Under D.83160, SoCal filed the instant application and requests authorization to include within its PGA procedure the cost of certain Canadian gas to be purchased from its wholly owned subsidiary, Pacific Interstate Transmission Company (PIT). PIT will initially purchase the gas from the Northwest Alaskan Pipeline Company (Northwest Alaskan). Sale of the gas is scheduled to commence about October 1981.

Specifically, the application involves costs associated with importation into the United States of up to 240 MMcf/d of natural gas at the Canadian border; approximately 215 MMcf/d will ultimately be delivered at the California/Arizona border. The gas will be sold by

Pan-Alberta to Northwest Alaskan for export to the United States. The purchased gas will be delivered to the Pacific Gas Transmission Company (PGT) at Kingsgate, British Columbia and then transported to the interconnection with Northwest Pipeline Corporation (Northwest) facilities at Stanfield, Oregon. Northwest will transport the gas to the El Paso Natural Gas Company (El Paso) and El Paso will deliver the gas to SoCal at the California/Arizona border. The Canadian government has approved export of the Pan-Alberta gas for a period of seven years.

In order to transport the Pan-Alberta gas as described, certain additional facilities must be constructed. The gas will be transported through a pipeline system that requires the early construction or "prebuilding" of a portion of the Western Leg of the ANGTS in both the U.S. and Canada. The cost of the needed additions is about $192 million on the PGT system, $132 million on the Northwest system, $56 million on the PIT system,and $24 million on the El Paso system. Therefore, the application involves costs associated not only with the purchase of Pan-Alberta gas but also with the prebuilding of portions of the Western Leg of the ANGTS.

The sale by PIT of Pan-Alberta gas and its transportation to SoCal is part of the prebuilding of the ANGTS and has received approval from the FERC. In a supplemental order issued by FERC on June 13, 1980, the western prebuild project was determined to be "required by the public convenience and necessity" and the transactions involved, including the importation of Pan-Alberta gas, were determined to be necessary to the construction and operation of the ANGTS.

In light of FERC's pronouncement, the presiding administrative law judge limited the scope of the instant proceeding and indicated that the scheduled hearings were not "intended to duplicate the federal process by determining whether public convenience and necessity require the prebuild project." Rather, the hearing was reserved for treatment of the following issues:

1. Is the PGA the appropriate mechanism for treatment of costs incurred by applicant in purchases of gas associated with prebuilding a portion of ANGTS?
2. What are the rate-design implications of this new gas supply?
3. What criteria did applicant's management employ in determining that purchase of gas associated with prebuilding a portion of ANGTS is prudent?

Evidentiary hearings were conducted in Los Angeles on February 3 - 6, 1981. SoCal, Southern California Edison Company (Edison), San Diego Gas & Electric Company (SDG&E), Pacific Gas and Electric Company (PG&E), the cities of San Diego and Los Angeles (Cities), General Motors (GM), the California Gas Producers Association (CGPA), Toward Utility Rate Normalization (TURN), the California Manufacturers Association (CMA), and the Commission staff appeared and participated actively. The matter was submitted pending receipt of both concurrent opening briefs and closing briefs. Application 59793 is now ready for decision.

Evidence and Position of the Parties

SoCal

SoCal sponsored the testimony of two witnesses and presented affirmative evidence responsive to the three questions at issue in the proceeding. In sum, SoCal contends that the PGA is the appropriate procedure for recovering of the costs associated with the prebuild natural gas which is scheduled for full delivery in October 1981. Further, SoCal argues that its evidence demonstrates that under current Commission rate design guidelines all classes of customers will benefit from the prebuild supply and lower priority users will bear their fair share of the cost of the prebuild gas for the first seven years of the project to the extent that it is consumed by those customers. Finally, SoCal believes that it has

fully demonstrated that its management prudently considered many criteria in deciding to mitigate curtailment by proceeding with the Pan-Alberta project, which will provide deliveries of Canadian gas for seven to twelve years and which will allow access to a long-term supply of Alaskan gas.

1. The PGA Procedure as Appropriate Mechanism for Recovery of Pan-Alberta Gas Costs

In support of its position that the PGA is the appropriate vehicle for cost recovery, SoCal presented testimony demonstrating that the historical reasons underlying establishment of the original PGA procedure are equally applicable today and support inclusion of Pan-Alberta costs in the PGA. Before adoption of the PGA procedure, recovery of purchased gas costs was addressed in general rate cases. With the advent of rapidly escalating gas costs, the "test year" forecasting approach of rate cases proved to be an impractical mechanism for purchased gas cost recovery. In response, the Commission adopted "tracking" procedures with no provision for balancing under- or overcollections. However, frequent increases in supplier rates required a proliferation of "tracking" applications. To obviate the need for filing numerous "tracking" applications, the Commission chose to establish the PGA as an orderly procedure for recovery of purchased gas costs.

SoCal contends that the rationale for establishing the PGA procedure supports use of the PGA for cost recovery of the prebuild volumes. A separate "tracking" mechanism would increase the administrative burden on the Commission, the utility, and interested parties without providing any additional control on the level of costs ultimately borne by the ratepayer. SoCal notes that no mechanism other than the PGA procedure was recommended by any party to the proceeding and contends that there is no record evidence supporting any alternative procedure.

2. Rate Design Implications of the Pan-Alberta Gas Supply

It is SoCal's understanding that rate design guidelines in recent Commission decisions have called for the referencing of the average residential rate to the average retail rate. Low priority retail rates are referenced to alternative fuel cost. GN-1 and GN-2 rates are currently set at the average retail rate. SoCal testified that application of these guidelines will result in lower priority users paying for the cost of the Pan-Alberta gas over most of the life of the project to the extent the Pan-Alberta supply permits natural gas service to those priorities. This contention is predicated upon the assumption that the delivered price of the Pan-Alberta volumes will be less than or equal to the low priority rates established by the Commission. SoCal acknowledges that during the first couple of years of the project the cost of Pan-Alberta gas may well exceed the low priority retail rates and that low priority users will not pay for the cost of the Pan-Alberta gas; however, this phenomenon should be short-term.

SoCal explained why the cost of Pan-Alberta gas may exceed low priority rates in the initial years of the project. To understand this phenomenon, one must recognize the method by which the delivered cost of Pan-Alberta volumes is computed in contrast to the manner by which the Commission establishes the low priority retail rate. The delivered price of Pan-Alberta gas at the California border consists of two components, the Canadian border price plus transportation charges. The Canadian border pricing formula references the cost of Pan-Alberta gas to a world oil price. Transportation charges are added to arrive at the delivered price at the California border. On the other hand, the low priority retail rates, under Commission guidelines, are referenced to low sulfur fuel oil prices in southern California.

Given these two different pricing mechanisms, SoCal cites two reasons why the cost of Pan-Alberta gas may exceed low priority retail rates during the first years of the project. First, the low sulfur fuel oil price in southern California will not reflect the world oil price until the phased deregulation of U.S. oil prices is completed. Second, some of the pipeline facilities are being depreciated as a part of the Pan-Alberta project although they will eventually be part of the ANGTS project. As soon as the Alaskan portion of the ANGTS project begins construction, the depreciation rate will be lowered on the prebuilt facilities which, in turn, will reduce transportation costs and ultimately the delivered cost of Pan-Alberta gas.

SoCal presented a tabular comparison of the estimated cost of Pan-Alberta gas and the projected low priority retail rate applicable to P-5 customers:

Description	Units	1982	1983	1984	1985
Pan-Alberta Gas Cost	$/MMBtu	7.34	8.11	8.17	8.99
P-5 Rate	$/MMBtu	6.83	7.59	8.43	9.35

SoCal maintains, from a rate design standpoint, that there is no inconsistency in the fact that the highest priced gas coming into the system may be higher than the lowest priority rate. In support of its position, SoCal provides the following rationale:

> When the Commission sets rate design guidelines and curtailment priorities, it does so to reflect conservation and social goals as well as certain economic conditions. Under these circumstances, the supply acquisition policy, which has long-term implications, must be separated from rate design policy. Once supply acquisitions are judged necessary to serve P-1 through P-4 requirements, rates must then be designed to recover the gas costs and the costs of operating the system.

> To design rates which result in the loss of the low priority market because of short-term market phenomena would increase costs to all other ratepayers, hinder the development of new gas supply sources and increase the use of imported oil. In addition, gas supplies acquired under SoCal's current gas supply acquisition policy are to the benefit of all users, not just one class of users. For example, if gas from El Paso, which is one of the lowest priced supplies, were curtailed, it does not follow the highest priority users are curtailed. Therefore, there appears to be little value in associating gas supply costs with priorities served for purposes of rate design.

SoCal also presented estimates of the rate design impacts of the Pan-Alberta project under two different scenarios. The first scenario assumes no supplemental supplies and is based on average temperature year conditions. Projections are provided respecting the P-5 rate, the cost of Pan-Alberta gas, the reduction in curtailment of P-5 customers resulting from the Pan-Alberta supply, and the average unit price increase to all other customers associated with the fact that the P-5 rate may be below the cost of Pan-Alberta gas.

Line	Description	Units	1982	1983	1984	1985
1	Crude Oil Price	$/BBL	36.96	41.03	45.54	50.55
2	P-5 Rate	$/MMBtu	6.83	7.59	8.43	9.35
3	Pan-Alberta Purchases	MMMBtu	78,511	78,511	78,511	78,511
4	Pan-Alberta Gas Cost	$/MMBtu	7.34	8.11	8.17	8.99
5	P-5 Sales with Pan-Alberta Purchases	MMMBtu	40,384	24,220	0	0
6	P-5 Sales without Pan-Alberta Purchases	MMMBtu	0	0	0	0
7	Reduction in P-5 Curtailment Due to Pan-Alberta Purchases (line 5 minus line 6)	MMMBtu	40,384	24,220	0	0
8	Percent of Pan-Alberta Purchases to P-5 (line 7 divided by line 3)	Percent	51	31	0	0
9	Percent of Pan-Alberta Purchases Paid for by P-5 $\left(\frac{\text{line 2 times line 7}}{\text{line 4 times line 3}}\right)$	Percent	48	29	0	0
10	Additional Revenue Requirement to P-1 Through P-4 Customers [(line 8 minus line 9) x (line 3 times line 4)]	M$	17,288	12,734	0	0
11	Average Unit Price Increase Associated with Additional Revenue Requirement $\left(\frac{\text{line 10}}{\text{sales}}\right.$ times 10)	¢/Therm	0.22	0.16	0	0

SoCal's estimates indicate that after 1983 all of the Pan-Alberta gas would go to P-1 through P-4 users in an average temperature year. In 1982 the fact that the P-5 rate would be below the Pan-Alberta cost results in an average unit rate increase to other customers of 0.22 cents per therm. SoCal argues that this increase is minimal given the benefits to the higher priority users of the Pan-Alberta project. These benefits, although difficult to quantify, are as follows: (1) without the volumes associated with the project, there could be curtailment of P-3 and P-4 users as early as 1982 in a cold year and (2) the volumes associated with the project assure consumers in California access to a long-term domestic supply source - Alaskan natural gas.

SoCal's second scenario assumes the availability of supplemental supplies and is also based on average temperature year conditions.

Line	Description	Units	1982	1983	1984	1985
1	Crude Oil Price	$/BBL	36.96	41.03	45.54	50.55
2	P-5 Rate	$/MMBtu	6.83	7.59	8.43	9.35
3	Pan-Alberta Purchases	MMMBtu	78,511	78,511	78,511	78,511
4	Pan-Alberta Gas Cost	$/MMBtu	7.34	8.11	8.17	8.99
5	P-5 Sales with Pan-Alberta Purchases	MMMBtu	134,974	111,988	85,938	45,002
6	P-5 Sales without Pan-Alberta Purchases	MMMBtu	56,232	36,326	18,576	0
7	Reduction in P-5 Curtailment Due to Pan-Alberta Purchases (line 5 minus line 6)	MMMBtu	78,742	75,662	67,362	45,002
8	Percent of Pan-Alberta Purchases to P-5 (line 7 divided by line 3)	Percent	100	96	86	57
9	Percent of Pan-Alberta Purchases Paid for by P-5 $\left(\frac{\text{line 2 times line 7}}{\text{line 4 times line 3}}\right)$	Percent	93	90	88	60
10	Additional Revenue Requirement to P-1 Through P-4 Customers [(line 8 minus line 9) x (line 3 times line 4)]	M$	40,339	38,203	(12,829)	(21,174)
11	Average Unit Price Increase Associated with Additional Revenue Requirement $\left(\frac{\text{line 10}}{\text{sales}}\right.$ times 10)	¢/Therm	0.52	0.48	(0.16)	(0.26)

(Red Figure)

The fact that the Pan-Alberta cost is above the P-5 rate in 1982 results in an average increase to other customers of only 0.52¢ per therm. This increase would be about equal to the per therm amount that the depreciation rate will be lowered on the ANGTS portion of the Pan-Alberta project with the startup of construction on the ANGTS project. SoCal argues that the minimal increases to be borne by P-1 through P-4 customers in 1982 and 1983 are clearly warranted by the direct future benefit to P-1 through P-4 customers of availability of Pan-Alberta volumes and access to Alaskan gas.

Although the rate to P-5 users may be below the cost of the Pan-Alberta supply in the first two years, SoCal concludes that this would have little impact on the rates to higher priority users. In contrast, the benefits to all SoCal's customers of a secure supply of Canadian gas and access to Alaskan gas are significant. Thus, SoCal maintains that all of its customers will benefit from the prebuild supply and under current Commission guidelines all customers will reasonably assume a share of the costs.

3. Management's Criteria for Determining Prudency of Gas Purchases

SoCal sponsored testimony explaining the criteria which its management employed in determining that purchase of Pan-Alberta gas is prudent. The paramount criterion used by SoCal focused on the need for gas in southern California. Given the projected decline in gas receipts from traditional suppliers along with the projected demand for natural gas in southern California, SoCal concluded that it is necessary to obtain new gas supplies in this decade and the next in order to avoid curtailment of high-priority customers. Although SoCal is currently receiving limited short-term supplies, it still views the long-term outlook for conventional

domestic gas as unfavorable. When Canadian gas, the most reliable foreign source of new supply, became available through the Pan-Alberta project, SoCal felt that it was a logical decision to buy the gas since the need for new supplies was apparent.

In support of its claim that there is a need for the Pan-Alberta volumes, SoCal sponsored testimony demonstrating which specific customer classes will experience reduced curtailment as a result of receipt of the prebuild supplies. Table I, which assumes the availability of supplemental supplies, indicates deliveries by priorities in the years 1981 through 1985 under average, cold, and hot temperature conditions.

TABLE I

DELIVERIES BY PRIORITIES 1981 - 1985

INCLUDES SUPPLEMENTAL SUPPLY

(In MCF)

		Average Temperature Conditions			Cold Temperature Conditions			Hot Temperature Conditions		
		With Pan-Alberta	Without Pan-Alberta	Difference	With Pan-Alberta	Without Pan-Alberta	Difference	With Pan-Alberta	Without Pan-Alberta	Difference
1981	Priority									
	P-1	513,813	513,619	194	585,752	585,558	194	468,934	468,740	194
	P-2A	58,266	58,266	-	60,522	60,522	-	56,859	56,859	-
	P-2B	46,936	46,936	-	46,970	46,970	-	46,852	46,852	-
	P-3	117,724	117,724	-	107,737	107,737	-	117,529	117,529	-
	P-4	37,834	37,834	-	34,838	34,838	-	37,800	37,800	-
	P-5	207,070	174,964	32,106	145,842	113,736	32,106	253,799	221,693	32,106
	Total	981,723	949,423	32,300	981,723	949,423	32,300	981,723	949,423	32,300
1982	Priority									
	P-1	500,936	521,167	(231)	592,889	593,120	(231)	476,052	476,283	(231)
	P-2A	59,180	59,180	-	61,401	61,401	-	57,763	57,763	-
	P-2B	48,311	48,311	-	48,365	48,365	-	43,267	43,267	-
	P-3	115,436	115,436	-	107,581	105,456	2,125	115,238	115,238	-
	P-4	38,173	38,173	-	35,081	28,683	6,398	38,077	38,077	-
	P-5	134,974	56,232	78,742	71,693	1,474	70,219	161,613	102,871	78,742
	Total	917,010	838,499	78,511	917,010	838,499	78,511	917,010	838,499	78,511
1983	Priority									
	P-1	529,700	529,800	(100)	602,268	602,368	(100)	454,430	454,530	(100)
	P-2A	61,304	61,304	-	63,549	63,549	-	52,662	52,662	-
	P-2B	48,823	48,823	-	48,978	48,978	-	48,848	48,848	-
	P-3	116,336	116,336	-	108,499	97,776	10,723	116,194	116,194	-
	P-4	38,402	35,453	2,949	33,120	15,144	17,976	38,306	38,306	-
	P-5	111,908	36,306	75,602	50,299	387	49,912	159,043	80,432	78,611
	Total	906,683	828,172	78,511	906,683	828,172	78,511	906,683	828,172	78,511
1984	Priority									
	P-1	533,442	533,561	(119)	613,303	613,422	(119)	493,358	493,477	(119)
	P-2A	60,339	60,339	-	62,652	62,652	-	58,856	58,856	-
	P-2B	49,254	49,254	-	49,312	49,312	-	49,208	49,208	-
	P-3	118,655	115,531	3,124	106,108	80,708	25,460	118,451	118,451	-
	P-4	38,901	30,542	8,359	29,222	6,243	22,979	38,801	38,801	-
	P-5	85,938	18,576	67,362	31,872	1,466	30,406	133,855	55,610	78,245
	Total	892,529	813,803	78,726	892,529	813,803	78,726	892,529	813,803	78,726
1985	Priority									
	P-1	549,559	549,433	126	624,801	624,675	126	502,595	502,469	126
	P-2A	62,163	62,163	-	64,560	64,560	-	60,627	60,627	-
	P-2B	49,371	49,371	-	49,427	49,427	-	49,325	49,325	-
	P-3	120,510	119,727	783	110,340	48,474	61,866	120,305	120,305	-
	P-4	39,042	6,442	32,600	16,519	-	16,519	38,914	38,914	-
	P-5	45,002	-	45,002	-	-	-	93,851	15,466	78,385
	Total	865,647	787,136	78,511	865,647	787,136	78,511	865,647	787,136	78,511

Table II, which also indicates deliveries by priorities for 1981 through 1985 under average, cold, and hot temperature conditions incorporates the conservative assumption that supplemental supplies will not be available to SoCal.

TABLE II

DELIVERIES BY PRIORITIES 1981 - 1985

EXCLUDES SUPPLEMENTAL SUPPLY

(in 10³CF)

		Average Temperature Conditions			Cold Temperature Conditions			Hot Temperature Conditions		
		With Pan-Alberta	Without Pan-Alberta	Difference	With Pan-Alberta	Without Pan-Alberta	Difference	With Pan-Alberta	Without Pan-Alberta	Difference
1981	Priority									
	P-1	513,836	513,644	192	585,145	584,953	192	468,927	468,735	192
	P-2A	58,236	58,236	-	60,522	60,522	-	56,859	56,859	-
	P-2B	46,936	46,936	-	46,990	46,990	-	46,892	46,892	-
	P-3	111,724	111,724	-	107,789	107,789	-	111,529	111,529	-
	P-4	31,894	31,894	-	34,828	34,828	-	37,800	37,800	-
	P-5	201,011	168,969	32,108	185,849	153,741	32,108	253,716	221,608	32,108
	Total	981,723	949,423	32,300	981,723	949,423	32,300	981,723	949,423	32,300
1982	Priority									
	P-1	520,191	520,193	(2)	592,744	592,746	(2)	475,907	475,909	(2)
	P-2A	59,163	59,163	-	61,401	61,401	-	57,163	57,163	-
	P-2B	48,311	48,311	-	48,365	48,365	-	48,267	48,267	-
	P-3	115,436	114,247	1,189	105,707	41,252	64,455	115,238	115,236	-
	P-4	38,113	1,233	36,880	14,058	-	14,058	38,077	8,510	28,513
	P-5	40,384	-	40,384	-	-	-	87,023		
	Total	822,215	743,764	78,511	822,215	743,764	78,511	822,215	743,764	78,511
1983	Priority									
	P-1	529,704	529,393	311	602,272	601,961	311	484,434	484,123	311
	P-2A	61,334	61,334	-	63,549	63,549	-	59,862	59,862	-
	P-2B	48,893	48,893	-	48,948	48,151	797	48,848	48,848	-
	P-3	116,396	99,107	17,289	99,013	25,036	73,978	116,194	116,194	-
	P-4	36,691	-	36,691	3,425	-	3,425	38,306	29,670	8,636
	P-5	24,220	-	24,220	-	-	-	69,564	-	69,564
	Total	817,238	738,727	78,511	817,208	738,697	78,511	817,208	738,697	78,511
1984	Priority									
	P-1	539,189	538,856	333	613,010	612,677	333	491,105	490,772	333
	P-2A	60,339	60,339	-	62,652	62,652	-	55,856	55,856	-
	P-2B	49,254	49,254	-	49,312	23,147	26,165	49,208	49,208	-
	P-3	117,093	50,673	66,420	52,435	607	51,828	118,451	98,287	20,164
	P-4	11,569	-	11,569	-	-	-	38,601	-	38,601
	P-5	-	-	-	-	-	-	19,028	-	19,028
	Total	777,449	698,723	78,726	777,449	698,723	78,726	777,449	698,723	78,726
1985	Priority									
	P-1	548,684	548,682	2	623,926	623,924	2	501,120	501,118	2
	P-2A	62,163	62,163	-	64,500	49,466	15,034	60,627	60,627	-
	P-2B	49,371	49,371	-	49,427	5,193	44,234	49,325	49,325	-
	P-3	94,861	18,361	76,500	19,181	-	19,181	120,305	66,508	53,797
	P-4	2,015	-	2,015	-	-	-	18,287	345	17,942
	P-5	-	-	-	-	-	-	6,830	-	6,830
	Total	757,094	678,583	78,511	757,094	678,583	78,511	757,094	678,583	78,511

SoCal's evidence shows that curtailment in P-1 through P-4 is not forecast in 1981 under either scenario. This is due to the current availability of short-term natural gas, which is caused in large part by the diversion of temporary excess intrastate gas to the interstate market under Sections 311 and 312 of the Natural Gas Policy Act (NGPA), and by reduced demand resulting from conservation, higher prices, and the recent recession. However, SoCal contends that as early as 1982, under both scenarios, the Pan-Alberta supply will directly benefit P-1 through P-4 by insuring that the requirements of these customers will be served in a cold year. Since deliveries from El Paso and Transwestern Pipeline Company (Transwestern) are heavily contingent upon availability of short-term interruptible supplies, this firm gas supply provides much needed security for P-1 through P-4 customers.

Although the predominant consideration in management's decision to purchase Pan-Alberta volumes centered on SoCal's need for gas, other criteria also guided the determination to purchase the supply. SoCal listed the following criteria and factors as supporting the ultimate choice:

a. The prebuild project will involve the early construction of portions of the ANGTS. The record developed before FERC set forth the many ways in which the prebuild project will aid and facilitate the construction of ANGTS and bring a major long-term (20-25 years) domestic gas supply to California at a price less than would be available if prebuilding were not to occur.

   Thus, when SoCal's management considered obtaining a new long-term supply of Canadian gas, it also recognized that the prebuild project would pave the way for an even greater and longer lasting supply of Alaskan gas.

b. In addition to ensuring SoCal's customers a more secure source of supply in the future, the Pan-Alberta project will also benefit the State's economy and will help reduce air pollution. Second, the FERC has determined that the importation of this gas for the southern California market is in the public interest, given the country's objective to displace fuel oil.

c. Of all potential new supply projects, the Pan-Alberta gas supply is one of the most secure and economically favorable. While the price of this supply is higher than the current price of domestic supplies under federal price controls, it is lower than current prices for some domestic decontrolled gas. Furthermore, viewed over the long run, this gas supply will provide Californians with clean energy at a cost at least competitive with, and most likely below, the cost of alternative fuels. In addition, domestic gas discovered after 1977 is scheduled to be decontrolled in 1985 with the possibility of earlier deregulation. Thus, virtually all new gas supply projects will depend upon natural gas whose price is deregulated and significantly higher than the price of domestic gas under federal price controls.

d. The prebuild supply will benefit the highest priority requirements. P-1 customers may not be directly affected by curtailment of P-2 through P-4 customers; but they are indirectly, adversely affected by the resulting negative effect on employment, output, and prices. In addition, residential customers bear both the pecuniary and nonpecuniary cost of increased air pollution when curtailment of natural gas supplies occurs.

In sum, although short-run aberrations may occur as they have currently, SoCal's management feels it must be guided by the need to adhere to long-run supply acquisition policies.

Southern California needs energy for the long run, and SoCal must plan in that light. The current increased supply availability is short-term in nature and subject to interruption because of weather and economic conditions in both the Southwest and Northwest. SoCal continues to believe that the gas supply from the Pan-Alberta project is necessary to meet its customers' requirements.

Edison and SDG&E

As large customers of SoCal, Edison and SDG&E share a common interest. Both utilities support the inclusion of the Pan-Alberta costs in SoCal's authorized PGA. Further, both Edison and SDG&E are firmly convinced that the Pan-Alberta supply is needed and will provide both short- and long-term benefits to SoCal's customers.

While neither Edison nor SDG&E presented direct evidence, both made similar arguments in their briefs. Their positions may be summarized as follows:

1. In contrast to SoCal's traditional supplies, Pan-Alberta constitutes a reliable supply that can be counted upon regardless of weather conditions. During winter months, when SoCal's traditional supplies are customarily curtailed, the Pan-Alberta supply will be available up to the contract maximum every day. The supply is also flexible in that SoCal can nominate any quantity from its minimum-take obligation up to the contract maximum.

2. Traditional supplies will decline during the life of the prebuild project. Furthermore, the estimates of supply available from traditional sources include some gas purchased under Sections 311(b) and 312 of the NGPA. Such gas is not a reliable supply since it is subject to uncertainties of weather in the producer state as well as to local jurisdictional control. This temporarily excess intrastate gas is given the lowest priority on the seller's system, and the seller has the right to withhold this gas from the interstate market whenever it is needed anywhere in the state from which it originates. While Section 311(b) gas is important, it is a variable

supply that neither SoCal nor its customers can totally rely on for planning purposes. Reliability of supply is especially important for P-5 customers who reach decisions regarding oil purchases partially upon the basis of the amount of gas they can count on from SoCal.

3. All of SoCal's customers will benefit substantially over the life of the Pan-Alberta project. Aside from the apparent benefits of a secure long-term supply and improved access to Alaskan gas, evidence indicates that Priorities 3 and 4 will benefit directly from the Pan-Alberta gas in average-year scenarios beginning in 1985, three years before the initial seven-year authorization for the gas expires. In the absence of prebuild volumes, current staff supply projections show curtailment in a cold year for Priorities 3 and 4 in all years analyzed. In a cold-year scenario, even Priorities 1 and 2 could benefit in 1984 and 1985 if variable supplies are unavailable. The probability that P-5 customers will be the primary recipients of the gas in the project's early years does not contradict the fact that all classes of customers will ultimately benefit from the availability of Pan-Alberta supplies. The prebuild volumes will afford firm protection to high-priority customers.

4. The price of the Pan-Alberta gas, although higher than other SoCal supply sources, compares favorably to the cost of other alternative supplies. In fact, testimony indicates that there was no cheaper supply of gas in the quantities involved and with the same reliability of service available anywhere in the world.

CMA and GM

Both CMA and GM agree that the Pan-Alberta project, judged solely on its own merits, may not be warranted. The evidence clearly demonstrates that in the initial years of the project virtually all of the gas will be made available to SoCal's P-5 steam-electric generation customers. Both CMA and GM also noted that the record presents serious questions regarding the marketability

of Pan-Alberta gas to SoCal's P-5 customers. Projections indicate that the estimated cost of the gas delivered to SoCal ($7.34/MMBtu) will exceed the estimated P-5 rate ($6.83/MMBtu) in the first full year of operation. As a result, other customers of SoCal will necessarily pay higher rates in 1982 because of the purchase of these Canadian volumes. However, both parties acknowledged that the short-term adverse economics of the Pan-Alberta project may well be outweighed by the long-term economic benefits relating to availability of and access to Alaskan gas.

Since the Pan-Alberta acquisition can be justified only in terms of potential long-term benefits and since all of SoCal's customers stand to benefit, GM and CMA contend that the cost of the prebuild supplies should be allocated among all of SoCal's customers. It would be inappropriate to conclude that P-5 customers are disproportionately benefited by the availability of Pan-Alberta gas and unfair to assess such customers a disproportionately higher rate for the gas. Evidence demonstrated that the level of P-5 contribution to fixed costs and return is reduced from roughly $215 million to $177 million when Pan-Alberta gas is provided to P-5 customers. While this loss of contribution has a "cost" of 0.5¢/therm which customers in P-1 through P-4 will bear, sales to the P-5 class, as a whole, continue to make a very substantial contribution in excess of gas costs.

Both CMA and GM conclude that the Commission, when weighing the propriety of the sale of Canadian gas to low priority customers, should consider the fact that such customers will continue to provide a very positive contribution to recovery of the utility's fixed and other variable costs. If there are long-run

advantages to this gas supply project, they should be weighed both in terms of the incremental cost-rate differential and the level of contribution provided by the P-5 class which would be receiving the gas in the early years.

CMA and GM caution the Commission to avoid the conclusion that, because one of several supply sources provided to a particular customer class bears a cost in excess of the rate charged that class that customer class in any way fails to provide revenues sufficient to meet its allocated cost of service. Nor should the Commission conclude that, because one supply source of several provided to a given class bears a cost of $7.00 per MMBtu all sales to that class must bear a rate of $7.00 per MMBtu.

CGPA

It is the position of CGPA that in view of the extraordinarily high delivered cost of the proposed Pan-Alberta deliveries to SoCal in southern California, these purchases must be kept to the minimum volume levels specified in the SoCal contract, as modified by FERC's June 13, 1980 Order. Any "discretionary" purchases above the minimum FERC-modified contract delivery level should be made only in accordance with an ascending level of cost - with the objective of reducing the overall cost of SoCal's natural gas purchases to a minimum level. These discretionary takes should be subject to intense scrutiny by the California Public Utilities Commission (CPUC) in future SoCal rate increase proceedings.

Because of the benefits to both SoCal and PG&E, SoCal should make every effort to secure additional California "firm" and "best efforts" natural gas supplies from PG&E before any "discretionary" purchases of high-cost Canadian gas are made.

In determining the cost sequence of SoCal's natural gas purchases, careful examination should be made to determine the extent to which SoCal's underground natural gas storage injections and withdrawals must also be scheduled - at least for the next few years - to place an absolute "cap" on SoCal's purchases of expensive Canadian gas at the minimum FERC-authorized delivery levels.

Compared to the high delivered costs of the Pan-Alberta gas, the present delivered cost of SoCal's other natural gas supplies are only 11%-61% of Canadian gas cost levels:

Source	Delivered Price ($/MMBtu)	Relationship
Pan Alberta	$7.80*	100.0%
PG&E-SoCal	$4.78**	61.3%
Transwestern	2.77	35.5%
California	2.25	28.8
El Paso	2.20	28.2
Federal Offshore	0.84	10.8

* Based on present $4.94 per MMBtu Canadian border price plus $2.86 per MMBtu transportation costs (minimum volumes)

** Per PG&E Application 60263, filed February 17, 1981.

Therefore, CGPA contends that before purchasing any more than the absolute minimum volume of Pan-Alberta gas supplies, every effort must be made to purchase the maximum available supplies of gas from alternative lower cost gas sources, including additional "firm" and "best efforts" natural gas supplies from PG&E.

The 1981-85 minimum required annual Canadian natural gas purchase volumes under the Western Leg Prebuild natural gas purchase contracts as modified by the FERC June 13, 1980 Order were calculated as follows:

Minimum Pan-Alberta Volumes at California Border (MMcfd)

Volumes	1981	1982	1983	1984	1985
Average Annual Contract	215.0	215.0	215.0	215.0	215.0
Average Annual Minimum	136.6	132.2	125.4	120.5	116.2
Daily Minimum	80.3	77.7	73.8	70.9	68.4
% Load Factor	63.5%	61.5%	58.3%	56.0%	54.0%
Discretionary Volume	74.8	82.8	89.6	94.5	98.8

Accordingly, CGPA maintains that starting with 78,400 MMBtu per day in the fall of 1981, and increasing thereafter, there is a large volume of Pan-Alberta gas which is available for "discretionary", as distinguished from "mandatory", purchase. This volume amounts to 35%-45% of the 215,000 Mcf per day of delivered Pan-Alberta gas purchase volumes. It is this volume of "discretionary", Pan-Alberta gas purchases which must be subjected to intense and detailed scrutiny before the higher cost of any of these Canadian gas purchases are included in SoCal's consolidated adjustment mechanism.

CGPA presented evidence demonstrating the benefits of implementing lower minimum purchase volumes of Pan-Alberta gas. Instead of purchasing maximum purchase volumes delivered at the Arizona-California border of 215,000 Mcf per day, the minimum purchase volumes for 1981 would be 136,600 Mcf per day - a difference of 78,400 Mcf per day or 28.6 MDth (bcf) annually. Alternative "discretionary" supplies could be purchased from PG&E at a lesser cost.

Benefit to SoCal Gas:	Price (¢/MMBtu)
Purchase Price of:	
Pan-Alberta Gas	$4.94
Alternative Gas From PG&E	4.31
Savings	.63¢

Based on the 28.6 Bcf volume of avoided purchases from Pan-Alberta times 63¢ per MMBtu, there would therefore be a savings to SoCal of $18 million on an annual basis for making such purchases from PG&E.

1981	Mcf/Day	Bcf/Year
Maximum Purchase Volumes	215,000	78.475
Minimum Purchase Volumes	136,600	49,859
Difference	78,400	28.616

63¢ times 28.616 Bcf equals .....$18.0 million

In addition, another substantial benefit would accrue to PG&E. Taking the sales price of the gas to SoCal at $4.31 per MMBtu, and subtracting the $2.70 per MMBtu purchase cost of California gas, effective July 1981, the difference is $1.61. Then, for every additional million Btu's of natural gas which PG&E sells to SoCal, rather than having SoCal purchase it from Canada, PG&E can buy the additional supply of California gas at $2.70 per MMBtu and resell it for $4.31 per MMBtu. On this basis, the benefits to PG&E would be about $46.1 million annually.

Benefit to PG&E:	Price (¢MMBtu)
Sales Price to SoCal	$4.31
Purchase Cost of Calif. Gas	2.70*
Added Profit	1.61

*Effective July 1, 1981

$1.61 times 28.616 Bcf equals .....$46.1 million

CGPA concludes that in view of the present substantial oversupply of natural gas in the California natural gas market and its likelihood of continuing throughout 1981, and probably 1982, only the minimum, rather than the contract maximum, of high-cost Canadian natural gas supplies should be purchased by SoCal from Pan-Alberta.

Cities

The Cities challenge the prudency of SoCal's decision to commit itself to purchases of highly expensive Pan-Alberta volumes. They argue that at least through 1985 the cost of Pan-Alberta gas, either full formula or discounted, will remain higher than the P-5 alternative fuel price. They question whether SoCal has any customers that will buy $8/MMBtu gas. The Cities contend that if this gas could not be rolled in with SoCal's other gas supplies it could not be sold. They argue that SoCal management is motivated by a "gas-at-any-price" supply philosophy, and they ask that the Commission discourage this approach.

In general, the Cities take the position that the cost of Pan-Alberta is prohibitive and that SoCal should not be allowed to purchase it. If, however, the Commission decides that the prebuild is a necessary component of the total ANGTS, then the short-term adverse economic effects should be spread to all California gas ratepayers and should not be imposed solely upon SoCal's customers. Since all California gas consumers will ostensibly benefit from access to Alaskan gas, there is no justification for southern California ratepayers bearing all the costs associated with prebuilding the Western Leg of the ANGTS.

TURN

It is TURN's position that SoCal's application should be denied. Pan-Alberta gas will not benefit SoCal's high-priority residential and small commercial customers, yet these consumers will be forced to bear rate increases totaling up to $1 billion over the next four years because of this high-cost supply. TURN argues that the impact on a customer using only the lifeline amount could reach $25.10 in just the first full year of Pan-Alberta deliveries. Furthermore, the gas will be delivered to southern California at a price in excess of the cost of the oil that would be displaced. TURN concludes that California will be poorer overall as a result of this project.

TURN maintains that there is no realistic possibility that the Pan-Alberta supply will be required to meet high-priority needs. In support, TURN cites the staff's gas volumes which indicate that there is no Priority 1 and Priority 2 need for Pan-Alberta gas even in a cold year. SoCal's tabulations also show no high-priority need in its gas balances when availability of supplemental supplies is assumed. While SoCal shows Priority 2 need for the gas in 1985 in a cold year absent supplemental supplies, TURN contends that such a scenario is completely unrealistic since it assumes no purchases whatsoever from PG&E, Elk Hills, the Rocky Mountains, etc.

Since there is absolutely no need for Pan-Alberta gas among high-priority customers, TURN feels that it is patently unfair to burden those classes with the extremely high costs of Pan-Alberta gas merely because they are captive customers with no alternative source of fuel. On this ground alone, TURN urges the Commission to reject SoCal's request for PGA treatment of the Pan-Alberta gas.

In further support of its opposition to PGA treatment for the Pan-Alberta volumes, TURN notes that Pan-Alberta gas will be

cheaper than oil only if each of the following conditions prevail: (1) U.S. market conditions and reduced demand for gas continue to force a discount from the Canadian border pricing formula; (2) Pan-Alberta gas can be taken at full 100% of contract volumes; and (3) transportation costs are reduced in 1983-1984 as a result of a 12-year Pan-Alberta contract extension and the start of ANGTS construction in Alaska. TURN argues that conditions 1 and 2 are mutually incompatible and indicate the unlikelihood of the project ever proving to be economic for southern California.

TURN also tries to demonstrate that the minimum take requirements of the Pan-Alberta contract may well result in negative consequences for SoCal's ratepayers. Pan-Alberta gas will flow to SoCal through its El Paso lines. Since total capacity is limited to approximately the 1750 MMcf/day contract quantity, this much cheaper domestic gas may have to be turned back on any day that it may be available at the contract level in order to make room for the minimum daily quantity of expensive Pan-Alberta gas.

If the Commission rejects TURN's recommendation and approves the application, TURN urges the Commission to establish certain policy guidelines for SoCal's operations that will minimize the detrimental impact of the Pan-Alberta project on P-1 and P-5 customers. At a minimum, TURN requests that the Commission direct SoCal not to purchase discretionary Pan-Alberta gas when the cost is higher than the rate paid by the customer class that would receive the additional supply.

However, this policy would do nothing to mitigate the impact on high-priority customers of the mandatory 60% of Pan-Alberta purchases. Furthermore, this policy could result in SoCal's turning back discretionary Pan-Alberta volume because of costs when some

low-priority customers might be willing to pay that higher cost in order to obtain gas. Given these potential problems, TURN asks the Commission to direct the staff to investigate and propose more creative approaches to mitigate the rate design impact on P-1 and P-2 customers. Since actual recovery of Pan-Alberta gas costs will not be addressed until SoCal's October PGA filing, assuming approval of this application, the staff will have ample time to analyze and determine an appropriate mechanism for recovering the high cost of Pan-Alberta gas from the customers who actually benefit from the addition of that source.

TURN asks that the following rate design proposals be examined for possible adoption in SoCal's next PGA filing: (1) establishment of a demand charge or "access to service" charge for customers who will receive additional service because of the addition of Pan-Alberta supplies; (2) authorization of a system in which the utility accepts bids from its interruptible customers for amounts of gas to be purchased, for example, over a two- to three-year period, the highest bidder in each priority thus assuring itself of full service before anyone else in that priority; and (3) separate ratemaking treatment for the fixed and variable components of the cost of Pan-Alberta gas.

If the Pan-Alberta purchases are approved, TURN also asks the Commission to establish broad policy guidelines for SoCal's system operations. Such operational guidelines should cover three areas - sequence of takes, storage policy, and the maximum reasonable price to pay for discretionary gas.

Finally, it is TURN's position that SoCal's long-term supply planning should recognize a cost constraint. SoCal's apparent "gas at any cost" philosophy must be rejected, and the Commission must exercise a more active role in supervising SoCal's gas

supply planning. TURN generally supports the staff's iteration of an appropriate long-term gas supply policy:

> "...it would be reasonable to assume that the acquisition of a new increment of gas supply will provide economic benefits to the total system, or service area, if such supply is acquired at a price less than the cost of imported crude oil delivered to U.S. refiners, although a higher price might be justified based on air quality and supply security considerations."

TURN notes that its support for use of an imported crude test over the long term differs from its suggested P-5 rate or residual oil price standard for day-to-day discretionary gas purchase decisions. This dichotomy in positions is explained by the fact that imported crude does reflect the marginal cost of energy for California over an extended period while the short-run operation of the market is too complex and constrained to permit such a direct substitution of fuels.

Staff

The staff sponsored testimony in response to the three issues raised in the administrative law judge's ruling. Regarding the appropriateness of the PGA procedure for treatment of Pan-Alberta costs, the staff recommended that the Commission authorize SoCal to include such costs in its PGA.

With respect to the rate design implications of the Pan-Alberta supply, staff testified that the responsibility for recovery of the net increased costs will fall on those classes of customers who will not directly benefit from its availability certainly during the first two years of the project, and perhaps during the first five years. Staff estimated that the Pan-Alberta gas would primarily result in increased deliveries to Priority 5 service over the

first five years of the project, although from time to time, depending on weather conditions, Priorities 3 and 4 would also be served.

Staff's Energy Balances show that without Pan-Alberta supply there would be no curtailment of Priorities 1 or 2 service through 1985.

Staff prepared a comparison of estimated P-5 alternate fuel prices through 1986 and compared those with estimates of the Pan-Alberta gas prices both under full formula and considering a 14% discount by the Canadian government. The result of this comparison shows that even were the Canadian government to continue discounting the border price of the gas, the estimated cost of the Pan-Alberta gas delivered to California exceeds the estimate of P-5 reference price during the first five years of the project. Although staff concludes that the rates applicable to low-priority service under existing Commission guidelines will be less than necessary to recover the cost of Pan-Alberta gas, no recommendation was made for changing the rate design at this time. Staff did suggest that it may be appropriate to review rate design at the time rate relief is requested under PGA procedures.

Concerning the question of whether the Pan-Alberta project was a prudent supply decision by SoCal, staff offered testimony showing that the acquisition of the Pan-Alberta gas on a "stand-alone" basis would not reflect a prudent procurement policy. Staff found the project to be imprudent when measured by an economic test which considers the cost of a new increment of gas supply against the cost of imported crude oil delivered to U.S. refineries. Staff's evidence demonstrates that the cost of the Pan-Alberta gas delivered to the California border will be more than the cost of imported crude delivered to the U.S. for the first five years of the project,

unless market conditions force a discount in the Canadian border price. If the gas is discounted below the full formula price, however, Pan-Alberta gas will still be above crude prices through 1983, assuming that the construction of the ANGTS begins in 1983. If ANGTS begins construction after 1983, the depreciation schedule of the prebuild transportation facilities will continue to be on an 11-year basis rather than a 27-year basis and the Pan-Alberta price will exceed crude prices even under the Canadian discounted formula.

While staff concludes that a straight economic analysis of the Pan-Alberta project shows it to be imprudent, they indicate that there are unquantifiable benefits from the project which may, on balance, make it prudent. Staff leaves it to the Commission to decide whether the air quality benefits, reduced oil consumption, the connection between the Pan-Alberta purchases and ANGTS, and possible additional Canadian gas justify SoCal's take-or-pay supply contract. Staff further notes that in certifying the prebuild project and the importation and sale of the Pan-Alberta gas to SoCal, the FERC clearly found that the project was in the public interest and, in effect, concluded that any short-term adverse economics were justified by the long-term benefits. Staff, in its brief, does draw several conclusions from the record evidence in this proceeding. First, the Pan-Alberta gas will be purchased exclusively to serve SoCal's interruptible customers. Second, the Pan-Alberta supply will most probably be acquired at the prices above the cost of imported crude oil delivered to California refiners. Third, SoCal's high-priority customers while not directly benefiting from the Pan-Alberta supply will be required to bear substantial costs of this gas if current rate design guidelines remain Commission policy.

Staff acknowledges, as a practical matter, that FERC has already approved the Pan-Alberta project and that construction on the prebuild facilities has already commenced. However, in light of the conclusions which it has drawn respecting the Pan-Alberta supply, staff urges the Commission to address critical issues raised by the project.

First, the Commission should adopt specific economic criteria for large new increments of supply. If a project is sought to be justified as the basis of providing security of service to high-priority (P-1 and P-2) customers, the utility should be required to perform a cost-benefit analysis which weighs the probability of the occurrence of curtailments to high-priority customers and the magnitude of the cost of curtailments, against the cost of providing security from such curtailments. It may make economic sense to purchase extremely high-cost gas to protect against remote possibilities of curtailments, but SoCal should be required to present such an analysis and not use the mere possibility of curtailments as a blank check to purchase gas.

On the other hand, if a utility seeks to justify expensive new supply on the basis of serving interruptible customers, the Commission should require that the utility have the burden of demonstrating that the interruptible customers will be paying at least the marginal cost of this supply. Such a policy regarding SoCal's discretionary purchases has already been stated in D.91905 in Finding 36:

> "SoCal's policy of purchasing Canadian gas at a cost higher than its system average rates is reasonable so long as rates for low priority users, the principal beneficiaries of that gas, are set high enough to return that cost."

If it appears that a supply project will not be able to pass this economic test, the utility should have the burden of showing on what other grounds the Commission should find the project prudent. One possible justification for such a project might be to show that the delivered price of a new supply will be cheaper than the alternative fuels it replaces, or at least, be less expensive than the cost of imported crude as delivered to California refiners.

Second, the Commission should adopt specific economic criteria for SoCal's discretionary takes.

The June 13, 1980 FERC decision gives SoCal substantial opportunity to reduce its contract volumes of Pan-Alberta purchases. To ensure that SoCal knows in advance of its purchases exactly what the Commission will expect, the Commission should adopt in this proceeding specific economic criteria for the discretionary takes. The staff witness recommends that SoCal be prohibited from making any discretionary purchases unless the variable cost of the Pan-Alberta gas, on the day of purchase, is below the cost of imported crude as delivered to California refiners. For purposes of determining this rate, the staff witness recommends that the prices be referenced to the California Energy Commission publications to be made under the Petroleum Industry Information Reporting Act (SB 1444).

Finally, staff counsel urges the Commission to adopt new rate design guidelines. If SoCal will be indeed selling the gas at a loss under current Commission rate design guidelines, the Commission should order SoCal to propose a new rate design scheme whereby interruptible customers, those who will be the beneficiaries of Pan-Alberta supply, pay the full cost of this supply.

Staff counsel argues that the most efficient and economically sound basis for new rate design guidelines would be to create a market among interruptible customers for new supply increments. He notes that while it would be unacceptable to dedicate supply to interruptible customers, the Commission could authorize a bidding system whereby P-3 and P-4 customers were allowed to bid for options to purchase gas in preference to those interruptible customers, including P-5 customers, who had not acquired options to purchase.

Obviously, before such a bidding procedure could be established the Commission would have to first phase out the existing priority system for interruptible customers. But once established, the bidding procedure would have a number of advantages over the existing priority system. By creating market conditions among interruptible customers, the Commission will have the opportunity to determine exactly how valuable gas supply is to interruptible customers. Staff counsel contends that in addition to purely economic considerations there are equity reasons for changing Commission rate design guidelines. It is clearly unfair to P-1 and P-2 customers to have to bear the costs for the Pan-Alberta supply when it will be used to serve only interruptible customers. Even if there are air pollution and national security benefits of this supply, it is unreasonable for all of the burden of these benefits to be placed on SoCal's high-priority customers.

Discussion

A. The PGA as the Appropriate Procedure for Recovery of Pan-Alberta Gas Costs

Although we opposed the Pan-Alberta project at the FERC as contrary to the interests of California ratepayers, no appeal was taken from the FERC order of June 13, 1980 denying rehearing and reiterating the conclusion that importation of Pan-Alberta volumes as part of the ANGTS prebuild project is in the national interest. Construction has begun on the prebuild facilities, and SoCal is contractually bound to purchase the prebuild volumes from PIT. In light of these facts, it would be inappropriate to relitigate or collaterally attack the federal determination that there is a need for the Pan-Alberta project.

However, recognition by this Commission that the Pan-Alberta project has been found to be in the national interest by the FERC cannot be construed as unconditional support for the ANGTS. We are mindful that significant financial and marketability difficulties remain to be resolved before construction can commence on that project. At the appropriate time and place, we will address the issues of financial conditions or other project risks imposed upon the California consumer, independent of our approval today of ratepayer support for this gas supply. We must recognize that FERC and this Commission share concurrent jurisdiction over certain gas acquisition projects proposed by California utilities. We must also recognize that federal determinations of "public convenience and necessity" are predicated upon considerations of national interest while our analysis focuses more narrowly on the interests of the California ratepayers.

To avoid unwarranted duplication of information and unnecessary delay of needed energy projects, we must try, to the extent possible, to reconcile the parallel but significantly different standards of review employed by federal and state regulators in making energy-related determinations of "public convenience and necessity". Toward that end we will develop an economic test to assist utility management in determining whether the development of a new supply source is in the interest of California consumers. (See Section B of Discussion.) It is expected that future applications by California utilities for federal approval of gas supply projects will, in the absence of compelling reasons, meet this economic test of prudency.

With respect to the instant application, there is no basis, in law or in equity, for a Commission determination that SoCal's purchase of Pan-Alberta volumes is imprudent. In the federal decision, the need for the prebuild project was determined almost solely on the basis of its relationship to the ultimate construction and completion of ANGTS. Evidence of the economic impact of the prebuild project was considered relatively insignificant when contrasted with the nation's interest in facilitating the construction of a natural gas delivery system from Alaska. Furthermore, SoCal's acquisition of maximum available quantities of gas to reduce dependence on foreign oil has been prompted by the clearly enunciated policies of the Commission. (See D.89177.) Since today's decision modifies prior Commission gas acquisition policy to include specific criteria for determining a reasonable price to pay for new supplies, this new standard for assessing the prudency of an acquisition can only be applied prospectively.

Therefore, we will now address ourselves to the more germane issue of whether the PGA represents the proper mechanism for recovery of costs associated with the Pan-Alberta volumes. We conclude that the PGA is the appropriate cost-recovery procedure.

We agree with SoCal that all evidence submitted in this proceeding supports inclusion of the prebuild costs in the PGA mechanism. The historical reasons which originally prompted the establishment of the PGA still pertain and apply with equal force to the Pan-Alberta purchased gas costs. The PGA reduces burdensome administrative requirements while providing the Commission with the flexibility to monitor gas costs on the ratepayer's behalf in the most efficient manner. Accordingly, we will authorize SoCal to provide PGA and balancing account treatment for the purchased gas costs associated with the prebuild project.

B. Criteria for Determining the Prudency of Long-Term Gas Supply Purchases

The issue of which criteria SoCal used in determining the prudency of purchasing Pan-Alberta volumes engendered a lively discussion between the parties. The corollary question of which criteria should be employed by management in determining the prudency of future long-term gas supply purchases proved equally controversial.

SoCal's witness indicated that the company's basic gas acquisition policy is to obtain enough supply to meet Priority 1 through 4 demands under all temperature conditions. His testimony, in part, reads as follows:

> "I think California would be best served by getting as much gas into California as possible, under certain economic constraints, of course... But I think the more gas we get into California the better off the state is going to be...(Vol. 1, Tr. 35)...certainly there's a limit...to what we can pay for gas, but certainly our paramount concern above all else is to get enough gas in here to make sure our customers, when they get up in the morning and turn on their thermostat or their gas range have gas coming out of it." (Vol. 1, Tr. 25.)

Both TURN and staff counsel challenge the criteria employed by SoCal and characterize the company's supply planning efforts as based on a "gas at any cost" policy. They contend that SoCal's planning is so utterly pessimistic and conservative that the company always perceives itself as heading toward a severe shortage unless new supplies are required. Both recommend that SoCal's long-term supply planning explicitly consider economics as well as need.

In D.89177 dated July 31, 1978 the Commission gave policy support for the acquisition of maximum available quantities of gas

to reduce dependence on imported oil to the lowest possible level. The Commission did not, in that decision, provide any specific guidelines regarding prudent prices for new gas supplies. We will not now chastize SoCal for following our enunciated policy. However, with respect to future gas supply projects, some economic test must be established, even in an era of shortages, to assist the utility and the Commission in determining whether development of a new supply source is in the public interest. The Commission cannot simply accept a "gas at any cost" philosophy as a utility procurement policy.

Admittedly, these are times which pose very difficult and complex economic planning questions. As new gas supplies become more difficult to find and more expensive to develop, distribution companies are confronted with critical long-term purchasing decisions. Development of expensive new supply projects often requires prices in excess of alternate fuels as well as a shift of the risk from producers and interstate pipeline companies to distribution companies and consumers. The demands of project developers for such requirements as long-term take-or-pay provisions, cost-of-service tariffs, rate designs which include rolled-in pricing, and demand charges which cover all fixed costs have the potential to shield the producers and interstate pipeline companies from the interplay of a free marketplace. Since actual costs are disguised and not communicated to the consumer, the marketplace does not operate freely to reject gas where cost exceeds value.

The acquisition of such expensive gas supplies may, in the short run, alleviate fears of impending gas shortages and increase our sense of security. However, the price exacted for such a sense of security will create a situation in which the cost of service may very well exceed the value of gas obtained. The consequences of such

a situation are clearly not in the public interest. The negative consequences of such a situation become even more apparent when one recognizes that purchased gas costs now constitute about 70%, and by 1986 an estimated 85%, of a distribution company's revenue requirements.

If cost of service exceeds the value of gas, large-volume customers, who are very responsive to changes in the price of alternate forms of energy,will shift to the most economic alternative. The small-volume users, those with relatively inelastic demand and an inability to change fuels, will be left to pay rates which must be raised to cover fixed costs no longer recovered from the large-volume customers. Although in all likelihood fixed costs would ultimately be recovered, the financial stability of the distribution company would most likely be injured in the long run by this customer dislocation and reaction.

Furthermore, when considering the economics of longer-term supply projects, the simple expedient of determining that the rolled-in price to the consumer can absorb the price of the incremental supply is not satisfactory. As more incremental supplies are acquired, the danger increases that the system average supply price will exceed the price of alternate fuels and the potential for market dislocation becomes very real. Those distributors that have relied upon rolled-in pricing to ensure marketability of supply may, quickly and dramatically, find that they have lost a substantial part of their market since it is the consumer who will make the ultimate price decisions when gas prices are finally deregulated. It is even conceivable that if the price of gas turns out to be a great deal higher than the value of gas as a fuel the distribution companies' full cost of service might not be recoverable.

In the absence of market-oriented forces controlling the price of incremental supplies, distribution companies must consider the long-term economic consequences to themselves and the consumer of such purchases. Logic and sound business practice dictate that they employ an economic test to assist them in considering the prudency of purchasing expensive long-term incremental gas supplies.

We must, therefore, determine the appropriate economic test. Two alternative tests appear viable. The first test considers whether the net cost of the gas supply at the California border exceeds the price of imported crude to petroleum refiners in California over the life of the project. If the price of the gas supply at the California border exceeds the cost of feedstocks used in the production of alternative fuels, then the gas supply should not be acquired unless other relevant factors outweigh the economics of the project. The second test considers whether the net cost of the gas supply at the California border exceeds the price of alternative fuels displaced by importation of the natural gas over the life of the project.

The respective merits of these two tests should be analyzed in SoCal's next PGA proceeding. Until then, we will reserve judgment on which economic test is preferable. Furthermore, at that time, the parties should also address the propriety of establishing an economic test to determine whether the discretionary purchase of gas under long-term supply contracts is prudent or not. Any conclusion that is ultimately drawn regarding an appropriate economic test requires as its basic element the concept of a comparison with alternate fuels. However, there are other dynamics that must be weighed by utility management prior to any decision to acquire an increment of high-cost gas. Certain considerations can be cited as examples of elements which can have an impact upon management's determination to purchase a gas supply.

If an expensive source of supply includes a take-or-pay provision, management must consider the detrimental effect of such an acquisition upon the entire fuel mix. In an era of ever increasing gas costs, the distribution companies must make every effort to continuously purchase the lowest price fuel mix. SoCal is fortunate in that its system at present is relatively free to arrange its takes from various suppliers in a sequence that results in a least-cost supply mix over a range of demand conditions.

All parties to this proceeding agree that the appropriate sequence of takes from current supplies to the SoCal system should be arranged to insure a least-cost supply mix. We concur that SoCal's sequence of takes should be arranged in order of increasing prices; and, as system demand falls below available supplies, purchases should be backed out in order of decreasing cost so that a least-cost supply mix is achieved. Certainly, the fact that a high-priced incremental supply accompanied by take-or-pay obligations has the potential to force the backing out of less expensive supplies in the energy mix must be considered a negative element in the purchase equation. As a corollary issue, analysis should be made in SoCal's next PGA filing of the extent to which SoCal's underground storage injections and withdrawals should be scheduled to minimize the cost of SoCal's supply mix.

Conversely, there are justifications for purchasing a new increment of supply at prices in excess of imported crude prices or alternative fuel prices both in the short term and long term.

Air quality constraints or supply security considerations could conceivably outweigh a negative economic analysis. It would not be prudent to back out supplies if service to Priority 1 or Priority 2 would be jeopardized.

While the point must be made that no analysis can be set down in a rigid fashion, it should be clearly understood that an economic analysis based on the value of gas vis-a-vis alternate fuels must be made in evaluating new supplies of gas. No longer can the existence of a shortage be a blank check to purchase expensive gas. Economics could very well dictate that a shortage cannot be alleviated at prevailing prices.

C. Rate Design Implications of the Pan-Alberta Project

Much evidence was adduced respecting the rate design implications of the acquisition of Pan-Alberta gas volumes. The views expressed were varied and wide-ranging. On the one hand, SoCal concluded that each class of its users will pay a fair share of the prebuild gas costs under existing rate design guidelines. On the other hand, TURN and the staff contend that current rate design policies will result in a substantial share of Pan-Alberta gas costs being imposed on high-priority customers, P-1 and P-2, who do not require and will not benefit from this supply.

During the proceeding it was expressly indicated that specific rate design issues would not be addressed in the context of this application. Actual rate design treatment of the Pan-Alberta gas volumes will await the outcome of SoCal's PGA filing in October. At that time, the central issue will involve the most appropriate method for recovering the cost of Pan-Alberta gas from the customers who actually benefit from the addition of that new source.

In addressing this critical rate design issue, it will be necessary to establish two facts: (1) which class or classes of customers benefit from the addition of Pan-Alberta supplies and

(2) under current Commission rate guidelines which class or classes of customers bear - and the extent to which they bear - the costs associated with delivery of the prebuild volumes. Given this information, a rate design can be established which more closely correlates the actual costs and actual benefits experienced by a class or classes of customers as a result of the Pan-Alberta additions.

Much relevant evidence regarding the rate design issue has been presented in this proceeding. Such evidence will be incorporated by reference into the record of the proceeding in SoCal's October PGA filing. For example, the gas balances provided by SoCal and staff are useful tools in determining which class or classes of customers will benefit from the prebuild supply source. While we will not foreclose litigation of this issue, our preliminary review of the evidence indicates that the availability of Pan-Alberta gas to the SoCal system will result primarily in increased deliveries to Priority 5 service at least over the first five years of the project. Furthermore, with respect to the issue of which customers will bear the costs of Pan-Alberta gas under current Commission rate design guidelines, there is also much useful, although often contradictory, evidence available. Relevant evidence has been presented projecting the cost of Pan-Alberta gas over the life of the project, based upon application of the full Duncan/LaLonde border price formula as well as the discounted formula. In contrast, we also have estimates - once again over the life of the project - of alternate fuel prices which under current rate design guidelines would be used as a reference in setting rates applicable to Priorities 3, 4, and 5 service. However, our review indicates that it would be premature to draw any conclusions upon the basis of the current record. Finally, we note that both staff and TURN proposed certain rate design innovations in their respective briefs. Edison also sought unsuccessfully to

introduce evidence respecting specific rate design recommendations Although clearly beyond the scope of this proceeding, the respective merits of alternative proposals to the current Commission-authorized gas rate design certainly deserve consideration in SoCal's October PGA filing.

Findings of Fact

1. The FERC concluded on June 13, 1980 that importation of Pan-Alberta volumes as part of the ANGTS prebuild project is in the national interest.

2. The Commission did not appeal the conclusion of FERC that the prebuild project is in the national interest.

3. Construction of the prebuild facilities is underway.

4. SoCal is contractually bound to purchase the prebuild volumes from PIT.

5. SoCal purchased the prebuild volumes under enunciated Commission policy.

6. As part of the prebuild project, SoCal will incur costs associated with the purchase of up to 215 MMcfd of Canadian gas from PIT.

7. The PGA procedure is the most administratively flexible, effective, and least costly mechanism to monitor the cost of the prebuild gas supply on behalf of ratepayers.

8. The severe increases in the price of natural gas mandates that the Commission require utilities to purchase in the future a least-cost supply mix.

9. An economic test will assist utility management and the Commission in determining whether development of a new supply source is in the public interest.

10. The availability of volumes of prebuild gas to the SoCal system will result primarily in increased deliveries to Priority 5 service at least over the first five years of the project.

Conclusions of Law

1. SoCal's purchase of prebuild volumes, under enunciated Commission policy, is prudent.

2. Recovery of costs associated with SoCal's purchase of prebuild volumes is most appropriately treated in SoCal's PGA mechanism.

3. SoCal's discretionary purchases of natural gas should be made in order of increasing prices - with the objective of reducing the overall cost of SoCal's natural gas purchases to a minimum level.

O R D E R

IT IS ORDERED that Southern California Gas Company is authorized to provide PGA and balancing account treatment for the purchased gas costs associated with the Pan-Alberta project.

This order becomes effective 30 days from today.

Dated AUG - 4 1987, at San Francisco, California.

President

Commissioners