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Decision 96-06-004 June 6, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
Southern California Gas Company for
approval pursuant to the expedited
application docket of a long-term
agreement with Baker Commodities,
Inc. (U 904 G)

Application 95-12-049
(Filed December 18, 1995)

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O P I N I O N

Southern California Gas Company (SoCalGas) seeks approval of a long-term gas transportation service agreement between Baker Commodities, Inc. (Baker) and SoCalGas which was executed by both parties on August 22, 1995. The agreement provides for gas transportation service to Baker's facility located in the City of Vernon (Vernon) under negotiated rates. A copy of the agreement is attached to the application.[1] This agreement is expected to contribute up to $0.58 million more to the recovery of SoCalGas' authorized base revenues than would be the case without this agreement.

SoCalGas requests that the Commission approve this agreement unconditionally and without modification. SoCalGas also requests that the Commission finds as follows:

1. As of the time SoCalGas negotiated the terms of the agreement, there was a significant threat of bypass by the customer and the agreement would prevent uneconomic bypass.

1 For competitive and trade secret reasons, the prices, term, and contract quantities by which Baker would receive service have been redacted from the copy of the agreement attached to the application. The Commission has received the complete agreement.

2. Revenues over the life of the agreement will generate a positive contribution to SoCalGas' margin and will not fall below the class average long-run marginal cost (LRMC) of serving medium and high pressure noncore customers using greater than 200 MDth/year on SoCalGas' system as established in the Commission order adopting the LRMC implementation settlement (Decision (D.) 93-05-006).

3. The terms of the agreement are reasonable given the bypass options that were available to the customer.

SoCalGas also requests that the Commission make a specific finding that SoCalGas has been prudent in negotiating this agreement, which finding would be dispositive of any future prudence issues that might arise, absent a showing of special circumstances as enumerated in D.92-11-052.

Concurrent with the filing of this application, SoCalGas has also provided the Division of Ratepayer Advocates and the Commission Advisory and Compliance Division with responses to the Master Data Request contained in Appendix B to D.92-11-052.

SoCalGas alleges that it and Baker entered into the agreement in order to avoid uneconomic bypass of SoCalGas' gas distribution system at Baker's facilities located in Vernon. In D.92-11-052 (p. 6), the Commission found that, "Because SoCalGas faces a variety of bypass projects which appear imminent, no geographic limitation will be adopted on the applicability of the expedited approval process to SoCalGas contracts."

SoCalGas states that this application represents SoCalGas' efforts to retain customers on its system in the face of not one, but two interrelated threats of uneconomic bypass. First, Vernon is actively pursuing construction of a duplicate distribution system and has publicly announced its intent to compete for SoCalGas' customers.[2] As evidenced in SoCalGas' response to Master Data Request Question No. 2, it is likely that Vernon's entire system could be constructed within 12 months. Vernon's proposal to construct a duplicate distribution system has been actively supported by many large gas customers in Vernon. A May 31, 1989 letter to Vernon requested that the City explore the municipalization option, "putting the City of Vernon on a wholesale level similar to Long Beach Natural Gas." SoCalGas considers distribution system bypass (i.e., municipalization) to be equally as serious as interstate pipeline bypass and that it is prudent to act preemptively in offering customers competitive gas service under this expedited procedure.

Secondly, Vernon has publicly announced its intention to aggregate its total load and pursue transmission pipeline options other than SoCalGas.[3] If SoCalGas does not enter into such long-term transportation service agreements with its customers, gas service presently being provided by SoCalGas will likely be replaced by one of four potential bypass projects (i.e., Tenneco,

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2 Vernon's City Council Resolution No. 5946 states at Paragraph 7: "The City of Vernon hereby intends to establish a Gas Municipal Utility Department in order to provide gas utility services in the City of Vernon in competition with SoCalGas."

3 Vernon's City Council Resolution No. 5946, June 20, 1991, page 2, states: "The Chief Executive Officer of the Gas Municipal Utility Department is authorized to pursue alternative gas supply options other than SoCalGas." Additionally, in two separate briefings, Vernon made the following statements: (1) Concurrent Reply Brief of City of Vernon, September 28, 1994, page 13, ". . . The treatment of Vernon proposed by SoCalGas in this proceeding could not be better calculated to drive Vernon straight into the arms of the first serious bypass pipeline which ventures nearby."; and (2) Comments of City of Vernon on Proposed Decision of ALJ Barnett, December 8, 1994, page 7, "Needless to say, SoCalGas' and the Commission's treatment of Vernon to date makes Vernon a very likely customer for any bypass project."

Kern River Gas Transmission Company, Mojave Pipeline Company, or Pacific Gas Transmission Company/Pacific Gas and Electric Company). This was explicitly recognized by the Commission in its recent Expedited Application Docket (EAD) decision approving SoCalGas' long-term contract with Sunlaw Cogeneration Partners I (another SoCalGas customer located in Vernon) (D.95-01-040, Finding of Fact 3). In addition, another pipeline is now being studied by the Los Angeles Department of Water and Power (LADWP) and Southern California Utility Power Pool members.

In D.95-09-097 (Henkel-Emery EAD), the Commission requested SoCalGas in future EAD applications to evaluate the potential for bypass given the cumulative volume of EADs that have already been approved by the Commission. With respect to bypass potential in the Los Angeles Basin, the Commission has approved eight long-term contracts for SoCalGas customers located in the Basin. As discussed in SoCalGas' Master Data Response accompanying this filing, the volume served under these long-term contracts represents only a small fraction of the load that has been identified as being at-risk to bypass in the Los Angeles Basin.

Under the terms of the Global Settlement approved by the Commission, SoCalGas shareholders accept the full risk of any revenue shortfalls created by this discounted agreement over the five-year term of the Global Settlement. Under that same settlement, SoCalGas shareholders will remain at risk for shortfalls from SoCalGas' authorized tariff over the next decade as long as the Commission does not substantially change the method of setting rates for noncore customers.

The SoCalGas Agreement for service to Baker provides substantial additional margin contribution, in SoCalGas' opinion. First, SoCalGas faces a substantial bypass threat by virtue of Vernon's stated intent to municipalize gas distribution service. Assuming Vernon completed a duplicative distribution system by January 1, 1997 and that SoCalGas thereafter received the traditional wholesale rate espoused by Vernon's biannual cost allocation proceeding witness, SoCalGas estimates that this agreement will contribute about $0.31 million more to the recovery of its authorized gas margin than SoCalGas could otherwise collect without the agreement. Second, it faces an additional bypass threat when Vernon aggregates its customer load and bypasses SoCalGas' system altogether. Assuming that Vernon were to bypass SoCalGas' system on January 1, 1998 (one year after municipalizing), this agreement will contribute $0.58 million more to SoCalGas' authorized gas margin than SoCalGas could otherwise collect without the agreement.

SoCalGas asserts that it has negotiated a fair price given that the competitive alternative rates (either Vernon's expected traditional wholesale rate or that offered under the likely resulting pipeline bypass) would be lower than the rate negotiated by SoCalGas once the bypass alternative goes into service.

We will approve the agreement. It meets the three pronged test for approval: the threat of bypass by the customer was imminent; there will be a positive contribution to margin (CTM); and the terms of the agreement are reasonable. We will, however, impose the condition that (1) any discount to the Interstate Transition Cost Surcharge (ITCS) must be borne by utility shareholders and (2) SoCalGas shall not recover in rates, or include in cost allocation forecasts, 100% of revenue shortfalls, if any, resulting from this agreement. (See SoCalGas Global Settlement, Section II, approved in D.94-04-088.)

__Findings of Fact__

1. This application appeared on the Commission's Daily Calendar of December 28, 1995. There are no protests. A public hearing is not necessary.

2. SoCalGas has filed this application seeking approval of a gas transportation agreement with Baker.

3. There is an imminent threat of bypass posed by the City of Vernon.

4. The agreement will provide a positive CTM. In the absence of the agreement, bypass by Baker will be uneconomic.

5. It is the Commission's policy that all ratepayers are responsible on an equal basis for the stranded investment costs making up the ITCS, and thus the ITCS is to be applied in a nondiscriminatory manner, on an equal cents per therm basis.

6. The bypass threat in this case warrants the approval of the agreement, but only on condition that SoCalGas' shareholders shall assume 100% of the risk for the ITCS costs associated with this agreement and 100% of any revenue shortfall.

7. Except as set forth below, the rates and terms of the agreement do not pose an unreasonable risk to ratepayers.

8. Based upon all facts and circumstances known to the Commission at the time of this decision, SoCalGas' decision to enter into the agreement is prudent.

<u>Conclusions of Law</u>

1. The agreement should be approved as set forth below.

2. Because of the imminent threat of bypass, this decision should be effective today.

<u>O R D E R</u>

IT IS ORDERED that:

1. Except as expressly set forth in Ordering Paragraphs 2 and 3, the long-term intrastate natural gas transportation service agreement between Southern California Gas Company (SoCalGas) and Baker Commodities, Inc., executed on August 22, 1995, is approved under the procedures, terms, and conditions of the Expedited Application Docket established by Decision 92-11-052.

2. The agreement is approved on the condition that SoCalGas' shareholders shall assume 100% of the risk for the Interstate Transition Cost Surcharge costs associated with the agreement. SoCalGas shall file with the Commission Advisory and Compliance

Division on or before July 1, 1996 written acceptance of this condition.

3. The agreement shall expressly provide that SoCalGas shall obtain the Commission's approval, prior to effectiveness, of any modifications, including modifications which may be the result of mediation.

4. Sections IX and X of General Order 96-A are suspended to the extent that those sections require that this agreement be subject to future modification by the Commission.

5. SoCalGas shall not recover in rates, nor include in cost allocation forecasts, 100% of revenue shortfalls resulting from this agreement.

6. Approval of the agreement is dispositive of all prudence questions which might arise at a later date regarding the agreement, absent a showing of:

a. Misrepresentation or omission of material facts of which the utility is aware in connection with the utility's request for contract approval;

b. Gross negligence in determining whether a realistic threat of bypass exists; or

c. Imprudence in the utility's performance under the negotiated agreement.

This order is effective today.

Dated June 6, 1996, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

Commissioner Daniel Wm. Fessler, being necessarily absent, did not participate.