ALJ/JWA/tcg

Mailed
SEP 24 1996

ORIGINAL

Decision 96-09-095 September 20, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY (U 39 G) for an Order Pursuant to Section 1005.5(b) of the Public Utilities Code to Increase the Maximum Cost Specified in PG&E's Certificate of Public Convenience and Necessity to Construct the California Portion of the Expansion of its Natural Gas Pipeline.	Application 92-12-043 (Filed December 21, 1992)
And Related Matters.	Application 93-03-038 Application 94-05-035 Application 94-06-034 Application 94-09-056 Application 94-06-044

(See Decision (D.) 93-10-069 and D.94-12-061 for appearances.)

Additional Appearances

Applicant: Patrick G. Golden, Edward Kurz, Frank Lindh, and Judi Mosley, Attorneys at Law, for Pacific Gas and Electric Company.

Interested Parties: Matthew Brady, Attorney at Law, for the Department of General Services; Dennis W. De Cuir, Attorney at Law, for De Cuir and Somach; Elias G. Farrah and Keith T. Sampson, Attorneys at Law, for Pacific Gas Transmission Company; David J. Gilmore, Attorney at Law, for Southern California Gas Company; Steven Harris, for Transwestern Pipeline Company; and Paul M. Premo, for Foster Associates.

Special Appearances: Charles Ferguson and Christopher A. Hilen, Attorneys at Law, for Paula Rosput.

Commission Advisory and Compliance Division: Sarita Sarvate.

FIFTH INTERIM OPINION

1. Summary of Decision

The backbone credit mechanism--intended to relieve Pacific Gas and Electric Company (PG&E) expansion pipeline shippers from duplicative charges for backbone facilities--is terminated, effective immediately. The backbone credit has not fulfilled its original purpose and is not necessary in a competitive marketplace.

2. Historical Background

The Commission has long been concerned that shippers on PG&E's expansion pipeline, now known as Line 401, might be required to pay for original system facilities that they do not use. Line 401 shippers bypass older backbone facilities--principally Line 400--before entering PG&E's original system for local distribution service, but the costs of the bypassed facilities are bundled into distribution rates. In Application (A.) 89-04-033, the expansion certification proceeding, the Commission found it just and reasonable to eliminate such duplicative backbone charges.[1] The Commission found merit in PG&E's proposed method of crediting customers for the duplicative charges, but warned that problems could be reviewed in this proceeding.[2] The mechanism became known as the backbone credit.

The Commission granted PG&E temporary authority for the backbone credit,[3] and Line 401 went into service on November 1, 1993. In D.94-02-042 the Commission addressed a conflict between two important policies: (1) Line 401 shippers should not pay for

---

1 Decision (D.) 92-10-056, Finding of Fact 64, 46 CPUC2d 199, 213 (1992).

2 D.92-10-056, 46 CPUC2d 199, 209 (1992).

3 D.93-10-069, Finding of Fact 18, 51 CPUC2d 674, 685 (1993).

facilities they do not use, and (2) the costs of facilities should be recovered from customers for whom they were built. Faced with several imperfect choices, the Commission decided to continue the backbone credit and count associated revenue shortfalls as transition costs, to be recovered from all ratepayers.[4] The Commission considered abandoning the backbone credit in light of claims that it is unworkable, but preferred the adopted alternative.[5] Forgone revenues caused by the credits are now booked into a Backbone Credit Memorandum Account (BCMA), but no amortization of the account balance in customer rates has been authorized. PG&E is allowed to discount Line 401 rates but cannot discount below the backbone credit, in order to avoid competition with the original pipeline system.[6]

Since the opening of Line 401, marketers have dominated gas sales to noncore end-users in PG&E's service territory. Only PG&E's Electric Department and a few noncore customers pursue their own gas supplies. Through April 1995, marketers handled gas transportation nominations for 97% of noncore transactions.[7] Typically, the end-user is interested only in burnertip price and is indifferent to the gas supply basin or transportation route except as those factors affect price. Marketers view the backbone credit as part of the overall cost of service and price gas service to end-users competitively. They may offer end-users a small share of the backbone credit, but the credit does not simply

---

4 D.94-02-042, Finding of Fact 71, 53 CPUC2d 215, 251 (1994).

5 D.94-02-042, 53 CPUC2d 215, 241 (1994).

6 D.94-02-042, 53 CPUC2d 215, 239 (1994).

7 Exhibit 207, PG&E's Market Assessment Report, p. 2-2.

flow to end-users. The backbone credit is essentially a bargaining chip that is in play in the California gas market.[8]

The existence of the backbone credit has engendered secondary market transactions which maximize the availability of the credit. The credit is applicable only in certain Northern California locations, but exchange agreements have allowed other end-users in Northern and Southern California to accrue backbone credit benefits. For example, a Southern California end-user buying gas from Canada over Line 401 can exchange gas with a Northern California end-user buying gas from the Southwest over PG&E's Line 300. Before the exchange, neither end-user was eligible for the backbone credit. After the exchange, the Northern California end-user is eligible for the credit. The two end-users then share the benefits of the backbone credit by mutual agreement or by agreement with a marketer. Through May 1995, 91% of all Line 401 deliveries into Northern California were eligible for backbone credits.[9] In early 1996 the BCMA was accumulating backbone credit charges at a rate of approximately $500,000 per month.[10]

3. Procedural Background

Backbone credit disputes were heard in the market issues phase of this proceeding, initiated by ruling of the assigned Administrative Law Judge (ALJ) dated June 27, 1995. The ruling also reopened the proceeding regarding the reasonableness of PG&E's

---

8 Examination of PG&E witness Joseph Henri, Tr. 38:5190.

9 Exhibit 207, Table 3B-3, p. 3B-10.

10 Based on a May 1995 BCMA balance of $14.1 million (Exhibit 207, Table 3B-1, p. 3B-7), a December 1995 balance of $22 million (cross-examination of PG&E witness Sandra Burns, Tr. 46:6382-3), and a reduction in the backbone credit from $0.1319 per decatherm (Dth) in 1995 to $0.0528/Dth in 1996.

decision to construct the expansion, but this interim opinion does not address those issues. Nor does it consider market or reasonableness issues consolidated from A.94-06-044, PG&E's interstate transition cost surcharge (ITCS) proceeding.

After a July 7, 1995 prehearing conference, PG&E and several other parties produced individual market assessment reports. The reports were not submitted as prepared testimony, in order to allow informal presentation of market information and to alleviate some parties' concerns about discovery risks. On September 8, 1995, the ALJ convened a workshop on the market assessment reports. Thirteen parties subsequently filed post-workshop comments. The comments, some with attached market assessment reports, are part of the formal record in the market issues phase. Reports that are not attached to comments or not introduced into evidence are not part of the record on which this decision is based.

Following exchange of prepared testimony, two more prehearing conferences were held on February 8 and March 12, 1996. The ALJ convened 35 days of evidentiary hearings on market issues, beginning April 1 and ending June 5, 1996. The ALJ also convened eight days of evidentiary hearings on the decision to construct, beginning June 10 and ending June 20, 1996. Twelve parties filed timely opening briefs, covering both market issues and the decision to construct: PG&E; Pacific Gas Transmission Company (PGT); the Division of Ratepayer Advocates (DRA); Toward Utility Rate Normalization (TURN); Southern California Edison Company (Edison); San Diego Gas & Electric Company (SDG&E); El Paso Natural Gas Company (El Paso); the Energy, Minerals and Natural Resources Department and the Commissioner of Public Lands of the State of New Mexico (New Mexico); the Canadian Association of Petroleum Producers (CAPP); Amoco Canada Marketing Company, Amoco Energy Trading Corporation, Amoco Production Company, and Chevron U.S.A. Inc. jointly (Amoco/Chevron); Enserch Energy Services, Inc.;

and Norcen Energy Resources Ltd. (Norcen). Eleven parties filed timely reply briefs: PG&E, PGT, TURN, Edison, El Paso, New Mexico, CAPP, Amoco/Chevron, Norcen, the California Industrial Group and California Manufacturers Association jointly, and the Southern California Utility Power Pool and Imperial Irrigation District jointly. The two hearing phases were submitted for Commission decision on August 9, 1996, upon receipt of reply briefs.

Although the parties briefed many issues, this decision addresses only the future of the backbone credit.[11] It is necessary to sever this issue from the others because marketplace inefficiencies and ratepayer exposure to the risks of BCMA amortization are immediate and ongoing. We should review the booking of backbone credit costs now. We will examine PG&E's proposal to amortize the BCMA balance when we address other market issues, specifically disposition of PG&E's ITCS memorandum account, and the decision to construct.

4. Positions of the Parties

PG&E supports retaining the backbone credit unless gas transportation rates are unbundled. PG&E argues that the credit is necessary to prevent end-users from paying for facilities they do not use. Otherwise, Line 401 shippers will subsidize the cost of Line 300, which brings gas from Southwest supply basins to Northern California. According to PG&E, this would create a competitive advantage for Southwest suppliers and would increase overall gas costs to end-users. CAPP agrees, at least when Line 401 discounts are less than the amount of the backbone credit. PG&E and CAPP recommend awarding the credit to Line 401 shippers rather than original system customers, and propose expanding eligibility for the credit.

---

11 Issue 13 in Exhibit 561, the market issues comparison exhibit.

SDG&E prefers to continue the backbone credit, but only for end-users that make long-term commitments to use of Line 401. As well, the credit should be reduced to cover only the costs of Line 400 and other original system facilities that are looped by Line 401. Edison recommends continuing the backbone credit only if PG&E shareholders assume a portion of El Paso pipeline capacity held by Southern California Gas Company (SoCalGas); otherwise, the credit should be eliminated.

El Paso and TURN recommend elimination of the backbone credit. El Paso believes that PG&E's support of the backbone credit is part of its Line 401 pricing strategy, and that shareholders capture the value of credits applied to as-available service. El Paso points out that current prices for Line 401 service to Northern and Southern California are different by the amount of the backbone credit, demonstrating that the credit does not reach end-users. El Paso claims that PG&E's scheme of monthly determination of backbone credits for its Electric Department unfairly awards credits to ineligible power plants.[12] TURN contends that backbone credits for as-available service transactions and credits generated by exchange agreements are inconsistent with the Commission's intent, and that shippers paying discounted Line 401 rates are not charged for duplicative costs. If the backbone credit is retained, TURN argues for a revised scaling of costs in calculation of the credit.

DRA characterizes the backbone credit as a Line 401 subsidy at ratepayer expense.[13] DRA does not oppose giving PG&E the flexibility to award the backbone credit at its own risk, but recommends elimination of the BCMA and consequent ratepayer support of the costs of the credit. DRA agrees with El Paso that market forces can adequately protect end-users from paying duplicative backbone charges.

12 Exhibit 207, Table 3P-1, p. 3P-4.

13 Exhibit 228, which shows illustrative cash flows under different scenarios, using prices and costs developed during several off-the-record workshops.

5. Discussion

Line 401 was not yet in service when the Commission approved the concept of the backbone credit in D.92-10-056, and when the record underlying D.94-02-042 was closed. The record now before us allows review of actual market dynamics, including backbone credit transactions. The evidence is overwhelming that the credit has not fulfilled its purpose. We conclude that it should be terminated immediately.

First, it is clear that the backbone credit serves more to subsidize market participants than to protect shippers from duplicative charges. In the first months of Line 401 operation, PG&E offered few discounts for as-available service, apparently waiting to appraise market response to its new capacity. By early 1994, PG&E began offering substantial discounts to Northern and Southern California shippers. The difference between Northern and Southern California discounted rates was consistently near the value of the backbone credit. Throughout 1994 and early 1995, discounts to the tariff rate were approximately $0.10 per Dth in Northern California and $0.22/Dth in Southern California.[12] The $0.12/Dth difference is close to the $0.13/Dth value of the backbone credit. PG&E acts rationally in offering discounts based on the customer's competitive alternatives, but this policy serves to remove the backbone credit from the end-user. During hearings, the ALJ elicited evidence that the backbone credit winds up in the hands of PG&E shareholders and holders of upstream pipeline capacity.[13] Gas marketers typically hold or control that upstream capacity and package it in deals they make with end-users.

12 Exhibit 207, Table 3F-1, p. 3F-4.

13 Exhibit 228, which shows illustrative cash flows under different scenarios, using prices and costs developed during several off-the-record workshops.

is evidence that marketers sometimes share the backbone credit with end-users, but the shared amounts are typically only a penny or two per Dth. The record does not reveal how PG&E and marketers divide the majority of the credit.

Second, end-users taking discounted Line 401 as-available service do not pay the full costs of duplicative backbone charges. El Paso and TURN make the point that when discounts exceed or are a substantial fraction of the backbone credit, the end-user does not pay for unused backbone facilities. Line 401 discounts cannot be assigned to any particular element of end-user costs. However, under a discounted rate, any fair allocation of the discount to the costs of unused facilities will result in end-user costs that are less than the backbone credit. Because virtually all as-available service is contracted at discounted rates, the backbone credit at least partially subsidizes Line 401 costs.

Third, PG&E sets rates for as-available service competitively, and cost-based pricing elements like the backbone credit are unnecessary. It is the burnertip gas price that matters to the end-user. If a marketer or end-user is dissatisfied with Line 401 service because of perceived duplicative charges, he or she can take service from another source.

Fourth, many parties present evidence that the backbone credit is unworkable. As SDG&E states, the present backbone credit is overly broad. Although we have little evidence that PG&E is not complying with existing rules, for example the geographic rules approved in Resolution G-3122, it defies common sense that 91% of Northern California deliveries over Line 401 use no original system backbone facilities. Recorded BCMA accruals, which have reached $22 million in two years, are high compared to the cost of the facilities actually bypassed. The total revenue requirement for Line 400, the original system pipeline which Line 401 parallels, is only about $16 million per year. If we were to continue the backbone credit, we would limit it to original system facilities

that are looped by Line 401. The unbundling scheme authorized in Resolution G-3122 is too broad.

The apparently legal but unanticipated exchange agreements seen in the marketplace are contrary to the intent of the backbone credit. Southern California end-users do not face duplicative charges because they do not take service on PG&E's distribution system. They unfairly benefit from the backbone credit. We do not disparage market participants for taking advantage of such competitive opportunities, but the exchange agreements support PG&E's own conclusion that the backbone credit is a bargaining chip in the marketplace.

As DRA points out, protection against duplicative charges in a competitive market is inconsistent with Commission policies for the electric industry. In our current electric restructuring proceeding, we have ordered exit fees to ensure that utility costs are paid by the customers for whom the facilities were built.[14] In D.94-02-042 we chose protection from duplicative charges over customer responsibility for stranded costs, but the evidence in this proceeding and our recent electric industry policy support reversal of that choice.

In sum, inefficiencies and inequities associated with the backbone credit greatly outweigh its benefits to the end-users it is meant to protect. We will terminate the backbone credit immediately. With termination, issues regarding eligibility for the credit and scaling of costs within the credit become moot and can be dismissed.

6. Tariff Provisions

The Commission Advisory and Compliance Division (CACD) has identified a problem with PG&E's Advice 1923-G, which sought

---

14 D.96-04-054, Conclusion of Law 2 at mimeo. p. 18, Ordering Paragraph 2 at mimeo. p. 20 (1996).

authority to extend Line 401 interim rates beyond the December 31, 1995 termination date ordered in D.94-02-042. Because no party protested the advice filing, it was approved by letter from CACD to PG&E dated January 10, 1996.

In its current Schedule G-XF, submitted in Advice 1923-G, PG&E lists reservation and usage charges for both modified fixed variable (MFV) and straight fixed variable (SFV) rate options.[15] In D.94-02-042, the Commission retained MFV rate design for Line 401 but allowed PG&E to negotiate SFV rate agreements with individual firm service shippers.[16] PG&E's tariff offering of SFV rates exceeds the authority granted in D.94-02-042 and could mislead shippers regarding their opportunity to negotiate SFV rates. PG&E should correct Schedule G-XF to reflect the terms of D.94-02-042 when it files tariff revisions to terminate the backbone credit.

7. Proposed Decision

In compliance with Public Utilities Code § 311(d), the ALJ prepared a proposed decision in this matter. The proposed decision was mailed to all parties on August 20, 1996. PG&E, Edison, and CAPP filed timely comments; TURN filed a timely reply to comments. PG&E continues to advocate retention of the backbone credit in the absence of unbundled transportation rates, but PG&E does not believe the proposed decision contains any error of fact or law. Edison supports the proposed decision. CAPP concedes that the backbone credit needs revisions, but argues against its termination. TURN supports the proposed decision, and opposes CAPP's arguments.

---

15 Revised Sheet Nos. 17267-G and 17268-G, effective January 1, 1996.

16 D.94-02-042, 53 CPUC2d 215, 237 (1994).

In approving this decision we have reviewed and carefully considered the comments of the parties. We adopt the proposed decision without substantive change.

On August 21, 1996, one day after the proposed decision was mailed, PG&E filed concurrently a motion in this and other proceedings and a new application, A.96-08-043, which together seek Commission approval of a broad settlement known as the Gas Accord. The settlement, if approved, would unbundle PG&E's gas transmission services and resolve many outstanding regulatory issues. Consistent with PG&E's position on unbundling,[16] the Gas Accord would terminate the backbone credit. However, we anticipate opposition to the Gas Accord, and our review of it will take several months. No party argues for deferral of this order pending a decision on the Gas Accord.

Findings of Fact

1. The backbone credit is intended to protect PG&E original system customers from the costs of backbone facilities they do not use because they take service over Line 401.

2. It is necessary to consider the future of the backbone credit now, before addressing other market issues and PG&E's decision to construct Line 401.

3. Recent evidence on actual market transactions involving Line 401 substantially augments the theoretical evidence that supported authorization of the backbone credit in D.92-10-056, D.93-10-069, and D.94-02-042.

4. Since the opening of Line 401, marketers have dominated gas sales to noncore end-users in PG&E's service territory.

5. Marketers price gas service to California end-users competitively, based on costs of alternative supplies.

6. In today's market most backbone credit benefits do not reach end-users, but flow to PG&E shareholders and marketers that hold upstream pipeline capacity.

7. End-users taking discounted as-available service do not pay the full costs of duplicative backbone charges.

8. The backbone credit at least partially subsidizes Line 401 costs.

9. PG&E sets rates for as-available service competitively, making the backbone credit unnecessary.

10. The scope of the backbone credit authorized in Resolution G-3122 is too broad.

11. Retention of backbone credit benefits by Southern California end-users that execute exchange agreements is contrary to the purpose of the credit.

12. Protection against duplicative charges in a competitive market is inconsistent with Commission policies for the electric industry.

13. Inefficiencies and inequities associated with the backbone credit greatly outweigh its benefits to the end-users it is meant to protect.

14. The backbone credit should be terminated immediately.

15. With termination, issues regarding eligibility for the backbone credit and scaling of costs within the credit are moot.

16. PG&E has not justified offering tariffed SFV rates in Schedule G-XF.

Conclusions of Law

1. PG&E's request to retain the backbone credit should be denied.

2. PG&E should be ordered to terminate the backbone credit immediately.

3. The requests of PG&E and CAPP to establish new backbone credit eligibility areas and to award the credit to Line 401 shippers rather than original system customers of record should be dismissed.

4. SDG&E's request to limit the scope of the backbone credit should be dismissed.

5. Edison's request that PG&E shareholders assume a portion of SoCalGas' El Paso capacity in exchange for retaining the backbone credit should be dismissed.

6. TURN's request to revise the scaling of costs in calculation of the backbone credit should be dismissed.

7. PG&E should be ordered to revise Schedule G-XF to comply with D.94-02-042 regarding SFV rate options.

8. This order should become effective today in order to terminate the backbone credit immediately.

FIFTH INTERIM ORDER

IT IS ORDERED that:

1. The request of Pacific Gas and Electric Company (PG&E) to retain the backbone credit is denied.

2. PG&E shall terminate the backbone credit, effective October 1, 1996.

3. PG&E shall revise Schedule G-XF to comply with Decision 94-02-042 regarding straight fixed variable rate options, effective October 1, 1996.

4. Within five (5) days of the effective date of this order, PG&E shall file with this Commission, with service to all parties to this proceeding, revised tariff sheets which (a) effect the termination of the backbone credit, and (b) revise Schedule G-XF as ordered above.

5. The revised tariff sheets shall comply with General Order 96-A, shall become effective October 1, 1996, and shall apply to service on or after their effective date.

6. The requests of PG&E and the Canadian Association of Petroleum Producers to establish new backbone credit eligibility areas and to award the backbone credit to Line 401 shippers rather than original system customers of record are dismissed.

7. The request of San Diego Gas & Electric Company to limit the scope of the backbone credit is dismissed.

8. The request of Southern California Edison Company that PG&E shareholders assume a portion of Southern California Gas Company's pipeline capacity contracted with El Paso Natural Gas Company in exchange for retaining the backbone credit is dismissed.

9. The request of Toward Utility Rate Normalization to revise the scaling of costs in calculation of the backbone credit is dismissed.

This order is effective today.

Dated September 20, 1996, at San Francisco, California.

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