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Decision 97-03-005 March 7, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company (U 904 G) for Approval Pursuant to the Expedited Application Docket of a Long-Term Agreement with Inland Paperboard and Packaging, Inc.	(EAD) Application 96-12-038 (Filed December 17, 1996)

O P I N I O N

Southern California Gas Company (SoCalGas) seeks approval of a long-term gas transportation agreement between Inland Paperboard and Packaging, Inc. (Inland) and SoCalGas which was executed by both parties on November 21, 1996. The agreement provides for gas transportation service to Inland's plant located in Ontario under negotiated rates. A copy of the agreement is attached to the application.[1]

SoCalGas requests that the Commission approve this agreement unconditionally and without modification. SoCalGas also requests that the Commission find 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; (2) Revenues over the life of the agreement will generate a positive contribution to margin and will not fall below the class average long-run marginal cost (LRMC) of serving transmission customers using greater than 200 MDth/year and cogenerators on SoCalGas' system as established in the order adopting the LRMC implementation settlement (Decision (D.)

1 For competitive and trade secret reasons, the actual pricing terms by which Inland would receive service have been redacted from the copy of the agreement attached to the application. The Commission has received a copy of the entire agreement.

93-05-006); and (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 at a later date, absent a showing of certain circumstances as enumerated in D.92-11-052.

SoCalGas' application was filed pursuant to the terms of D.92-11-052, which was issued by the Commission on November 23, 1992. The decision adopted interim rules for the expedited approval of long-term negotiated discount gas transportation contracts. Also, the application was filed pursuant to the terms of D.86-12-009, D.89-10-034, and D.89-12-045 to the extent such decisions were not modified by D.92-11-052.

Concurrent with the filing of its application, SoCalGas provided the Office of Ratepayer Advocates and the Commission's Energy Division with responses to the Master Data Request contained in Appendix B to D.92-11-052. SoCalGas asserts that in accordance with D.93-02-058, which was issued in response to certain applications for rehearing of D.92-11-052, a motion seeking a protective order regarding the contents of the response to the Master Data Request does not accompany its application. SoCalGas states that, however, as provided in D.93-02-058, it will promptly seek such a protective order from the Law and Motion Administrative Law Judge in accordance with Resolution ALJ-164 in instances where disclosure of such material to a party to this expedited application docket (EAD) proceeding would violate the trade secret privilege enjoyed by SoCalGas or Inland (D.93-02-058, pp. 15-17).

<u>The Bypass Threat</u>

SoCalGas alleges that it and Inland entered into the agreement in order to avoid uneconomic bypass of SoCalGas' gas distribution system at Inland's Ontario plant. In D.92-07-047 (p. 6), the Commission found, "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 points out that in D.95-01-040 the Commission acknowledged the existence of several potential interstate bypass pipeline projects extending into the Los Angeles Basin (i.e., Tenneco, Kern River Gas Transmission Company, Mojave Pipeline Company, and Pacific Gas Transmission Company/Pacific Gas and Electric Company).

Further, SoCalGas points out that the Commission has recognized the threat posed by the potential pipelines, and as of this date, has approved 11 long-term contracts that SoCalGas has executed with other large customers located in the Los Angeles Basin. In all of the 11 decisions, the Commission consistently concluded that "there appears to be an imminent threat of bypass posed by four potential pipelines in the Los Angeles Basin." Also, SoCalGas points out that in D.95-01-040 the Commission acknowledged SoCalGas' internal cost analyses which demonstrate that the competitive rate for an extension from Daggett into the L.A. Basin could be very attractive for large customers. According to SoCalGas, these pipeline projects are all currently targeting the largest customers on SoCalGas' system, including the large loads in the Los Angeles Basin. And SoCalGas contends that once a large customer within a specific geographic area shows an interest in taking service from a bypass pipeline, it is plausible that the pipeline company would then target the next level of high-load customers similarly situated, i.e., large noncore users with high-load factors. Furthermore, according to SoCalGas, these pipelines would have the ability to build extensions to target groups of these geographically centered facilities. Therefore, SoCalGas contends that Inland represents an excellent candidate for a bypass project due to its large load, the concentration of other large load customers in its vicinity, Inland's high associated load factor and its close proximity to the interstate pipeline's existing infrastructure and to the proposed pipeline routes.

SoCalGas argues that although Mojave's cancellation of its northern expansion project in February 1996 removed the northern California bypass threat, it does not alleviate the bypass threat in southern California. Since the expansion project into northern California has been canceled, Mojave has only the southern California market left to exploit and is now free to focus its efforts on southern California. In addition, SoCalGas believes that the cheap expansion capability that would have been used for Mojave's northern expansion is still available for a southern California bypass project.

Further, SoCalGas argues that the possibility of the Kern River pipeline extending to southern California will increase because Williams Company, Inc. has recently purchased the remaining 50% of the Kern River pipeline previously owned by Tenneco, giving it sole ownership. According to SoCalGas' assessment, Williams paid a $45 million premium over book value. Accordingly, SoCalGas believes that the primary opportunity to recoup the $45 million premium would be through an expansion of the pipeline into southern California, which is the largest market accessible to the pipeline. Williams' 1995 Annual Report cited a strategy of "aggressively pursuant expansion opportunities...to capture incremental demand in every reachable market," indicating that their reasons for purchasing the remaining 50% of Kern River are also expansion oriented.

In addition, SoCalGas points out that two recent Federal Energy Regulatory Commission (FERC) rulings (Mojave Pipeline Company, 74 FERC ¶ 61,288 (1996), and Northern Natural Gas Company, 73 FERC ¶ 61,260 (1995)), create additional incentives for pipelines to expand and end-use customers to bypass. According to SoCalGas, the recent rulings modified FERC pricing policy allowing an interstate pipeline to roll in lateral costs, and rolled-in pricing may apply to expansion costs if the proposed project does not exceed the 5% rate increase threshold. The new pricing policy also allows pipelines to apply rolled-in rate treatment to a new pipeline project on the basis that avoiding a future rate increase resulting from a capacity turnback constitutes a systemwide benefit. SoCalGas believes that this will spur more customers to pursue direct pipeline service because they will not need to pay for the entire pipeline expansion costs. Further, SoCalGas argues that the Texas Eastern Transmission Corporation order (74 FERC ¶ 61,074 (1996)) reverses FERC's position on pipelines holding upstream capacity and may create the potential for Mojave to bundle its capacity with El Paso and move the pricing point for natural gas from the California border to a point farther downstream, thereby enhancing the price competitiveness of a Mojave expansion.

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. SoCalGas states that with respect to bypass potential in the Los Angeles Basin, the Commission has approved 11 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.

SoCalGas contends that had it been unwilling or unable to negotiate the agreement with this customer, Inland would have entered into a long-term transportation service agreement with one of the potential bypass projects to take service based on the results of its specific route/capacity. Such route and capacity, in turn, would be based on the results of an open season that has not as yet been held. In this regard, SoCalGas points out that attached to its application is the declaration of Glenn M. Sheeren, Manager of Energy and Government Relations for West Coast Operations, for Inland. Mr. Sheeren declares that, based on exploration of various transportation options, Inland believes that other pipeline alternatives would be available to serve its plant. Inland also believes that the rate for these pipelines would be more favorable than the tariff rate offered by SoCalGas. Mr. Sheeren describes Inland's intention to bypass SoCalGas if the Commission does not approve the agreement between SoCalGas and Inland. If the agreement is denied, he also describes Inland's intention to pursue lower cost bypass service at its plant as soon as possible in order to receive favorable terms.

Also, SoCalGas notes that attached to its application is an affidavit from Inland which verifies its intention to bypass the SoCalGas system absent Commission approval of the agreement with SoCalGas.

SoCalGas is informed by Inland that for reasons of confidentiality it may not disclose the actual terms of the offers presented to Inland by the competing companies.

Ratepayer Indifference To The Price SoCalGas Has Negotiated

SoCalGas acknowledges that under the terms of the Global Settlement, SoCalGas shareholders accept the full risk of any revenue shortfall created by this long-term contract over the five-year period of the Global Settlement. Additionally, SoGalGas agrees that its shareholders will remain at risk for any revenue shortfalls from tariff over the entire term of the contract as long as the Commission does not substantially change the method of setting rates for noncore customers. Therefore, SoCa!Gas submits that this contract entails minimal risk to any ratepayers over the term of the contract.

Additional Margin Contribution

According to SoCalGas, using class average costs of service for transmission customers using greater than 200 MDth/year and cogenerators,[2] SoCalGas estimates that this agreement will contribute $3.7 million more to margin than SoCalGas could hope to collect without the agreement.

SoCalGas says it obtained a fair price given that the competitive alternative could be lower than the rate negotiated by SoCalGas once the bypass alternative was in service.

Procedural Schedule

Pursuant to the procedural schedule adopted in D.92-11-052 for Expedited Application Docket filings, SoCalGas served a copy of its application on the prescribed parties. No protests to the application were received. Therefore, the Commission may address this matter *ex parte*.

Discussion

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; and the terms of the agreement are reasonable. We will, however, impose the condition that any discount to the Interstate Transition Cost Surcharge (ITCS) must be borne by utility shareholders.

Findings of Fact

1. This application appeared on the Commission's Daily Calendar of December 23, 1996. There are no protests. A public hearing is not necessary.

2. There is an imminent threat of bypass posed by various interstate pipelines.

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2 Since Inland's cogeneration load is served from the transmission system, the distribution costs assigned to the cogeneration class are excluded.

3. The agreement may provide a positive contribution to margin. In the absence of the agreement, bypass by Inland may be uneconomic.

4. Over the term of the agreement, SoCalGas' shareholders have accepted the full risk of any revenue shortfalls created by this discounted agreement.

5. The agreement allows for the possibility that the ITCS might not be fully recovered from the customer.

6. The ITCS is a transition cost anticipated under the Commission's Capacity Brokering Rules, calculated as a volumetric surcharge to recover various interstate pipeline costs.

7. Under Commission Capacity Brokering Rules, the ITCS is not subject to discounting.

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

9. The seriousness of the imminent bypass threat in this particular 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.

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

11. 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 Paragraph 2 and 3 below, the "Long-term Intrastate Natural Gas Transportation Service Agreement" between Southern California Gas Company (SoCalGas) and Inland Paperboard and Packaging, Inc. (Inland), executed on November 21, 1996, 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 percent of the risk for the Interstate Transition Cost Surcharge costs associated with this agreement. SoCalGas shall file with the Commission's Energy Division on or before April 7, 1997 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 to the agreement, 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 the agreement be subject to future modifications by the Commission.

5. SoCalGas shall not recover in rates, nor include in cost allocation forecasts, any revenue shortfalls resulting from the 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.

7. Expedited Application Docket 96-12-038 is closed.

This order is effective today.

Dated March 7, 1997, at San Francisco, California.

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