

Decision 98-06-083 June 18, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Wild Goose Storage, Inc. for A
Certificate of Public Convenience and Necessity to
Construct Facilities for Gas Storage Operations.

Application 96-08-058
(Filed August 26, 1996)

ORIGINAL

**ORDER ADDRESSING THE ALLOCATION
OF CAPITAL COSTS AND RESOLVING
THE PETITION FOR MODIFICATION OF DECISION 97-06-091**

In Decision (D.) 97-06-091, the Commission granted Wild Goose Storage, Inc. (Wild Goose) a certificate of public convenience and necessity authorizing it to develop, construct, and operate an underground natural gas storage facility and to provide firm and interruptible storage service. Remaining unresolved after that decision was whether we should establish rules, in advance, for the allocation of costs resulting from Pacific Gas and Electric Company's (PG&E) system upgrades related to the Wild Goose project. In addition, four Commissioners signed a dissenting opinion encouraging Wild Goose to file a petition for modification of a portion of D.97-06-091 that would require Wild Goose to file cost data with the Commission to justify that its rates do not fall below the company's short-run marginal cost. In this decision, we consider both of these issues.

Cost Allocation

In its comments to the proposed decision that preceded D.97-06-091, Wild Goose proposed that the Commission adopt a policy supporting the use of cost/benefit analysis to determine the appropriate allocation of costs related to future system improvements necessitated by Wild Goose's operations. We stated that while the proposal appeared to have merit, we were reluctant to adopt such a policy without providing other parties an opportunity to respond to the proposal. We left the proceeding open for the limited purpose of addressing this issue.

At a subsequent prehearing conference held on September 5, 1997, Wild Goose and PG&E proposed that the Commission adopt the following policy statement:

"The undersigned parties agree to the principle (set forth below) to assist in determining future responsibilities for transmission facility upgrades related to transportation service to and from the WGSJ storage facility. In light of the fact that no facility upgrade has been requested by WGSJ and that the customers of WGSJ have not as yet been identified, the parties recognize that a number of issues pertaining to the cost responsibility for such upgrades cannot be determined at this time with complete certainty, but instead will be the subject of later analysis and discussion between the parties. Such issues include, but are not limited to, the scope and interpretation of the cost/benefit analysis described below, as well as the definition and scope of 'net incremental revenues,' 'net present value,' 'costs of the facility upgrades,' and other terms. This agreement in principle is subject to review of, and approval or modification by, the Public Utilities Commission of the State of California.

"Once WGSJ requests that PG&E provide transportation service to or from its facilities on its behalf or on behalf of its customers, PG&E will determine the level of service it can provide to WGSJ without incurring any additional costs for facility upgrades. WGSJ will then decide if it is willing to accept this level of service. If WGSJ requests additional service requiring a facilities upgrade, the cost allocation for the upgrade will be determined pursuant to an analysis of the costs of the upgrade required to provide the requested level of service compared to the net incremental transportation revenues collected by PG&E which would not otherwise exist in the absence of the WGSJ storage operation. The analysis should reasonably compute the net present value (NPV) of the cost and incremental revenue -- including a reasonable period of time for amortizing the costs of the upgrade, and taking into consideration the risk associated with the forecast of future revenues used in the calculation. To the extent that the NPV is positive, there shall be no incremental charge for such upgrade to WGSJ or its storage customers. If the NPV is negative, WGSJ will pay for the upgrades to the extent needed to make the NPV equal to zero. The Commission will retain jurisdiction over the cost allocation of such transmission upgrades and will resolve directly or through alternative dispute resolution any disputes arising from the cost benefit analysis or any other issues related to the provision of transportation service to and from the WGSJ storage facility. This allocation of transmission upgrade costs is adopted to govern circumstances related to the WGSJ storage project and transmission

upgrades related to other storage projects shall be considered on a case-by-case basis.

"The level of service to be provided initially to WGSJ is subject to change due to increased use of the PG&E system or other alterations to the system determined to be necessary by PG&E. There is no express or implied obligation on the part of PG&E to pay for any such system upgrades based upon this document. Once an upgrade has been constructed to provide a specific requested level of service to or from the WGSJ facility, PG&E shall provide said level of service for the useful life of the upgraded facilities or the period of operation of the WGSJ facility, whichever is less, subject to the terms and conditions of its tariffs and any agreement between PG&E and WGSJ."

Essentially, PG&E and Wild Goose propose that the allocation of costs stemming from system upgrades needed to serve the Wild Goose project be governed by a cost/benefit analysis, the details of which would be determined at the time. Once it was determined that transportation system improvements were needed, the parties would try to predict both the cost of the improvements and the amount of the transportation revenues that would be collected by PG&E that "would not exist in the absence of the WGSJ storage operation." If PG&E and Wild Goose predicted that these revenues would exceed the cost of the improvements, then Wild Goose would not be required to pay for the improvements.

The Office of Ratepayer Advocates (ORA) opposes the adoption of a policy statement concerning the allocation of the cost of future system upgrades in the absence of an identified need for such an upgrade. In support of its position, ORA cites D.93-02-013, in which the Commission established other policies and rules for permanent natural gas storage programs.

We agree with ORA that it is not reasonable to adopt a policy statement concerning the allocation of cost to system upgrades in the absence of an identified need for such an upgrade. For this reason we do not adopt the proposed policy statement.

Petition for Modification

In D.97-06-091 granting Wild Goose a Certificate of Public Convenience and Necessity to operate its gas storage facility, the Commission determined that Wild

Goose must file rate tariffs, as required under Public Utilities (PU) Code § 489. It permitted Wild Goose to state those rates in terms of a "rate window," a range of rates within which the company could charge for its services. The Commission went on to state (mimeo. at p. 9):

"In authorizing Wild Goose to file tariffs with a rate window we must ascertain that the floor and ceiling rates are reasonable. Wild Goose's floor rate should not be below its short-run marginal cost. If Wild Goose is allowed to charge rates below its short-run marginal cost, Wild Goose may be engaging in predatory pricing, which would be unfair and perhaps illegal."

The Commission required Wild Goose to submit cost studies demonstrating that its rate floor is not below its short-run marginal cost, but allowed the company to provide those numbers only to the Energy Division and to keep the information confidential.

Four commissioners signed a dissent to D.97-06-091, expressing strong opposition to requiring Wild Goose to file or produce cost information. These commissioners encouraged the company to file a Petition for Modification seeking an elimination of this requirement. On July 21, 1997, Wild Goose filed such a petition. However, in this petition, Wild Goose went further, asking to be relieved of the requirement of filing minimum rates. On August 20, 1997, Southern California Gas Company (SoCalGas) filed a response in opposition to the relief sought.

In support of its request to be relieved of the requirement of providing a cost-based justification for its rate floor, Wild Goose makes the following assertions:

1. Wild Goose states that it has neither the market power nor the capacity to drive its key competitors, SoCalGas and PG&E, out of the storage market.
2. Wild Goose asserts that it would be unable to sustain rates above market levels.
3. Wild Goose states that its ability to engage in predatory pricing is negligible.
4. Wild Goose states that if it drops its rate below short-run marginal costs, the result will be that storage customers will benefit from low prices and the company's shareholders will incur a loss. Wild Goose asserts that it cannot create discounts by shifting costs to high priority core customers or

transportation customers the way a traditionally regulated gas distribution utility can.

In reviewing the instant petition, we did find that it is highly unlikely that Wild Goose, as a new entrant, could have such a negative impact on the incumbent investor owned utility that it would result in the utility having to exit the gas storage market. Wild Goose is the first, and so far only competitor to enter this market in California. The incumbent utility has 100% of the market share, while Wild Goose starts with a customer base of zero.

Assuming even if Wild Goose were to engage in predatory pricing, legal processes already exist for the Commission and courts to eradicate such behavior before it could have harmful impacts in the marketplace. The Commission and the courts have appropriate mechanisms in place for any potential harmed party to seek legal or regulatory relief. If Wild Goose, or in fact any other regulated utility, engages in anti-competitive behavior, a complaint may be filed with this Commission as well as at state and federal agencies charged with enforcing anti-trust laws. The courts also offer a venue for harmed parties to seek appropriate remedies.

Wild Goose has entered the storage business at complete risk to shareholders. We believe it is unnecessary to place a high regulatory burden on a new entrant, given the fact that ratepayers will not bear any portion of the risk for this investment. Public policy sometimes requires that we limit the downward pricing ability of utilities to ensure that, as a result of discounting to one group of ratepayers, other ratepayers are not harmed. Wild Goose has been granted market based rates, and like other utilities regulated by this Commission, will not be subject to a traditional cost-of-service rate-of-return regulatory framework. Because Wild Goose will be charging the market rate for all its services, a decrease in one rate does not lead to an automatic increase for customers of other services.

Allowing new entrants to file rates without any cost justification is not new to this Commission. For example, in the telecommunications industry, providers considered public utilities under PU Code §§ Section 216 and 234 are able to change

rates without providing any cost justification. Absent compelling evidence that the utility has significant market power, this is a reasonable way to regulate public utilities.

For the above reasons, we conclude that it is not necessary for Wild Goose to file cost data with the Commission to show that its tariff rates do not fall below the company's short-run marginal costs. We will not require that Wild Goose provide cost data to the Commission in order to have its tariffs approved and will modify D.97-06-091 to reflect this discussion.

Concerns regarding anti-competitive behavior, including predatory pricing, can best be addressed via the Commission's complaint or investigatory processes rather than requiring cost justification of tariffs. Because Wild Goose has authority for market-based rates, and because we do not find that Wild Goose has significant market power, there is no need for such data. Of course, Wild Goose must abide by any Commission rules regarding document and information retention and availability that generally apply to public utilities.

Findings of Fact.

1. The Commission cannot provide any meaningful guidance as to whether or not the proposed policy statement offered by Wild Goose and PG&E represents an acceptable policy statement in the absence of an identified need for such an upgrade.

2. It is unnecessary for Wild Goose to file a cost justification for its tariffed rates in order to provide adequate protection against predatory pricing and other anti-competitive behavior.

Conclusions of Law

1. The proposed policy statement concerning the allocation of capital costs for future system expansion related to the Wild Goose project should not be adopted.

2. D.97-06-091 should be modified by deleting the third full paragraph on page 9 (mimeo.) which begins with "In authorizing Wild Goose...".

3. D.97-06-091 should be modified by deleting the last paragraph on page 9 (mimeo.), which continues to page 10 (mimeo.) and begins with the phrase "Finally, we note..."

4. D.97-06-091 should be modified by revising Finding of Fact 16 to read: "There is no evidence that Wild Goose possesses significant market power."

5. D.97-06-091 should be modified by revising Finding of Fact 19 to read as follows: "Certain telecommunications utilities are allowed to file rates and tariffs without any cost justification, including evidence that their rates are above cost."

6. D.97-06-091 should be modified by revising Conclusion of Law 4 to read: "Wild Goose should be allowed to file tariffs without cost justification."

7. D.97-06-091 should be modified by revising Conclusion of Law 5 to read: "Wild Goose should be allowed to have market-based pricing because there is no evidence that Wild Goose has significant market power."

8. D.97-06-091 should be modified by adding a new Conclusion of Law to read: "Wild Goose should not be required to cost justify its proposed rate ceilings or floors and should be allowed to charge market based rates within a filed rate zone."

9. Conclusion of Law 6 in D.97-06-091 should be modified to read as follows: "6. Wild Goose should not be required to file its rate calculations along with its tariffs nor should the Energy Division require cost justification for any rate prior to those rates going into effect."

10. Ordering Paragraph 5 of D.97-06-091 should be modified to read as follows: "5. Wild Goose is not required to provide the Director of the Energy Division with the calculations used in developing its rates as part of the tariff review process, nor shall Energy Division require cost justification for any rate prior to those rates going into effect. In all other ways, Wild Goose's tariffs must comply with Commission rules and procedures."

11. In all other respects, the petition to modify D.97-06-091 should be denied.

ORDER

IT IS HEREBY ORDERED that:

1. The policy statement offered by Wild Goose Storage, Inc. (Wild Goose) and the Pacific Gas and Electric Company (PG&E) concerning the allocation of capital costs for

future PG&E system expansion needed to serve the Wild Goose storage project is not adopted.

2. D.97-06-091 is hereby modified by deleting the third full paragraph on page 9 (mimeo.) which begins with "In authorizing Wild Goose..."

3. D.97-06-091 is hereby modified by deleting the last paragraph on page 9 (mimeo.), which continues to page 10 (mimeo.) and begins with the phrase "Finally, we note..."

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11. In all other respects, the Petition for Modification of Decision 97-06-091 filed by Wild Goose on July 21, 1997 is denied.

12. Application 96-08-058 is closed.

This order is effective today.

Dated June 18, 1998, at San Francisco, California.

RICHARD A. BILAS

President

P. GREGORY CONLON

JESSIE J. KNIGHT, JR.

HENRY M. DUQUE

JOSIAH L. NEEPER

Commissioners