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ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Rulemaking on the Commission's Own Motion to
Assess and Revise the Regulatory Structure
Governing California's Natural Gas Industry.

Rulemaking 98-01-011
(Filed January 21, 1998)

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**INTERIM OPINION ON STEPS TO BE TAKEN TO
EXPLORE AND ADOPT A COMPREHENSIVE GAS STRATEGY**

In opening this rulemaking proceeding, we stated our intention to assess the current market and regulatory framework for California's natural gas industry and to adopt reforms that emphasize market-oriented policies that will benefit all of California's natural gas consumers. The underlying philosophical premise is that where there are competing providers of goods and services, the variety and quality of those offerings will improve and providers will be motivated to keep prices competitively low. Consistent with this philosophy, we seek to identify the services for which the public interest suggests the need for greater competition and determine the steps that we must take to facilitate healthy competition. We have considered the concerns of approximately 45 parties offered as written opening and reply comments and as oral comments at a full-panel hearing on April 6, 1998. Here, we discuss our plans to complete this assessment and adopt a long-term strategy. In addition, we take certain steps to improve the functioning of the current market in ways that should be compatible with any additional changes we may later seek to introduce.

Our Plans for Developing a Long-Range Gas Strategy

Market Structure Decision

In the context of natural gas utility regulation, the "market structure" describes the way gas and related services are provided to customers. It refers to the mixture of services that are provided exclusively by utilities, those that are provided only by competitors other than the utilities, and those that are provided by both. As reflected in the first sentence of our Order Instituting Rulemaking (R.) 98-01-011, it is our goal to regulate this industry in a manner that enhances the influence of competitive market forces. In order to identify an

appropriate structure for this natural gas market, we must understand how current market conditions affect competitive forces. On April 23, 1998, Commissioners Richard A. Bilas and Jessie J. Knight, Jr. (the assigned commissioners) invited participants to file market conditions reports to describe specific instances in which utilities have used or have the potential to use their control of transmission, distribution, storage or procurement systems to achieve an anti-competitive effect. In addition, they have asked parties to provide specific, concrete references to aspects of the utility control systems and operations that may give utilities the ability to impair competition.

We concur with the assigned commissioners that parties should submit such reports and concur with the timetable set forth in the April 23rd ruling, which required that reports be filed no later than July 15, 1998, and culminated with the submission of rebuttal to the reports no later than August 21, 1998. In addition, those who do not file reports and rebuttal may file comments on the reports by August 21, 1998. We plan to use the reports to establish facts pertinent to our determination of the appropriate market structure. We will hold evidentiary hearings if needed to resolve contested facts that are critical to our decision-making process. The comments that are filed concurrent with the rebuttal will be treated as argument and will not be given evidentiary weight.

The assigned commissioners have also asked parties to file requests for hearings on the date that rebuttal and comments are due. This is an important step, since the Commission must make a determination of the need for hearings before moving forward. At least one party seeks an opportunity to file such a request at some date after receiving and reviewing the rebuttal. We do not extend the time for filing such requests. However, if a party finds that the rebuttal showing of another party presents a compelling need for hearings that

could not have been identified at an earlier time, a party may file a motion for consideration of a late request for hearings and may attach its request to such a motion. Similarly, at least one party seeks the right to file rebuttal to another party's rebuttal showing. We do not anticipate allowing for such additional rebuttal. However, if a party finds that a rebuttal showing erroneously presents information as fact and that information may be critical to the Commission's decision, a party may file a motion for leave to serve additional rebuttal. Motions of either type must be filed no later than September 4, 1998.

Before identifying a proposed market structure we will conduct a series of non-evidentiary public participation hearings throughout the state. At these hearings we hope to receive comments on the merits of various proposals to restructure the gas market. We will schedule these hearings to occur after release of working group reports in mid-September to allow interested parties to reflect on all the various work products in their comments.

We will use these reports, comments, public participation hearings, and any necessary evidentiary hearings to frame our understanding of how existing market systems must be adjusted to provide the most benefit to all of California's natural gas customers. We plan to express our proposed approach in the form of a market structure decision, which will provide focus for our final determination of the appropriate market structure. Based on this preliminary decision, we will evaluate the applicability of the California Environmental Quality Act (CEQA), as discussed further below, and report our proposal to the California legislature to seek its guidance and any needed changes to the law.

In their April 23, 1998 ruling, the assigned commissioners required only the three respondents with the largest California customer bases to file Market Conditions Reports. The assigned commissioners encouraged other parties to file reports, as well. We specifically encourage the other respondents

(Southwest Gas and WP Natural) to participate actively in this process, since actions taken by the Commission in response to the Market Conditions Reports may affect those companies, as well.

In the report that accompanied our order beginning this rulemaking effort, the Division of Strategic Planning suggested various principles and objectives to guide our assessment of the market structure. We have considered those suggestions in light of the comments offered by various parties and agree that it is appropriate to state our goals in considering changes to the market structure.

Goals

In assessing the existing natural gas market structures and considering a long-term strategy for regulating the industry, we intend to pursue the following goals, among others:

1. To complement and enhance the benefits of electric restructuring.
2. To eliminate inappropriate cross-subsidies.
3. To guard against unnecessary barriers to the entry of competitors into various aspects of the natural gas market.
4. To mitigate competitive abuses that may occur because one firm exerts inordinate control over the functioning of the marketplace.
5. To enhance competition by providing separate rates for each major component of utility service and allowing customers to choose to have other firms substitute their services and charges where appropriate.
6. To ensure that the rates customers pay for utility services reflect the cost of those services.
7. To preserve the low costs currently enjoyed by California natural gas customers.
8. To provide adequate consumer protection.

9. To ensure that natural gas service is safe and reliable.

Implementation

By identifying the appropriate market structure, we will establish the context for addressing an array of implementation issues raised in the Strategic Planning report and in parties' comments. These include, among others, the adoption of regulatory reforms, the treatment of stranded costs, the provision of default service, and setting appropriate balancing requirements. Some changes, such as any we might make to rate design for utility services, may need to follow the resolution of other implementation issues. When we issue a decision on market structure, we will announce a schedule and process for considering all of these and other implementation issues.

Applicability of CEQA

On April 29, 1998, the Coalition of California Utility Employees and the Southern California Gas Workers Council (CCUE/SCGWC) filed a motion for determination of the applicability of CEQA to this rulemaking. CCUE/SCGWC argue that at least some of the proposals contained in the Division of Strategic Planning (DSP) report "Strategies for Natural Gas Reform" (January 21, 1998) cannot be adopted unless the Commission first undertakes analysis of potential environmental impacts pursuant to CEQA. Friends of the Earth filed a reply in support of the motion. Southern California Edison Company (Edison) and a combination of the Southern California Gas Company and San Diego Gas & Electric Company (SoCalGas/SDG&E) filed responses addressing portions of the motion. No one opposed the motion or suggested that CEQA might not apply to at least some of the actions set forth in the report.

The statutes comprising CEQA (Public Resource Code § 21000, et seq.) and the CEQA Guidelines (14 California Code of Regulations § 15000, et seq.) do not provide clear guidance as whether the type of government action

embodied in any final policy decision we issue in this area would fall within the requirements of CEQA. However, we note the following expression of the Legislature's intent in enacting CEQA:

"It is the intent of the Legislature that all agencies of the state government which regulate activities of private individuals, corporations, and public agencies which are found to affect the quality of the environment, shall regulate such activities so that major consideration is given to preventing environmental damage, while providing a decent home and satisfying living environment for every Californian." (Public Resources Code § 21000 (g).)

We acknowledge our responsibility to honor that intent. However, it is too soon to tell whether we will adopt policies in this proceeding that could affect the quality of the environment.

Where CEQA does apply, it applies to a decision that commits the agency to a definite course of action (14 Cal Code Reg § 15352(b)). Currently, we have before us a catalogue of options as identified by the DSP. In order to assess the applicability of CEQA in a meaningful way, we must first develop a proposed course of action based on that catalogue and other sources. Then, we can assess the applicability of CEQA to that proposal. If CEQA applies, we would undertake appropriate environmental review before issuing an order that commits the agency to a course of action.

We will deny, without prejudice, the motion currently before us. After we have issued an order identifying a proposed course of action, we will revisit the question of whether or not CEQA applies and would entertain any subsequent motions on this subject at that time.

Short-Term Steps

There are a number of steps we can take prior to choosing a market structure that will help us prepare for making decisions based on the market

conditions reports or will result in short-term improvements that should be compatible with any structural changes that we may adopt later. We detail these short-term steps below.

Working Groups

To help prepare for making a market structure decision, the assigned commissioners have created two new working groups. The Revenue Cycle Services Safety Working Group will address the safety concerns that have been raised by many commenting parties related to the introduction of competition in the provision of gas meters, metering services, and services on the customer side of the meter. In order to determine the appropriateness of allowing for competition for some or all of these services, we must be assured that any relevant safety concerns are adequately addressed. The assigned commissioners have asked this group to report its findings no later than September 15, 1998.

The Statewide Consistency Working Group will create a detailed inventory of significant inconsistencies in policies, programs, tariffs, rules, and procedures employed by gas utilities throughout the state. As time is available, we hope that this group will also identify inconsistencies that should be eliminated. The assigned commissioners have asked this group to report its findings no later than September 4, 1998. Both of these reports will be critical elements of our consideration of market structure and implementation issues.

Functional Unbundling of Costs, Rates and Services

In the market structure decision, we will identify the services for which customers should be able to choose a provider other than the utility. In order to facilitate such choice, a utility must provide its customers with bills that separately state the charges related to its various services. This price information is part of what a consumer or energy provider needs in order to make an

informed choice and provides a basis for charging only for those services purchased from the utility.

One can think of the unbundling process as involving three activities: separately identifying costs (cost separation), presenting bills that contain separate rates for each function (rate separation), and providing the option for customers to pay the utility for a particular service at the separate rate, or purchase the service elsewhere (competitive service). It is too soon to know with finality those services which should be competitive. We will suspend judgment about further service competition until after we have completed our review of the market conditions reports and the reports of the two working groups. However, there are certain things we do know, even at this early stage of this inquiry:

1. Various firms can now compete to provide electric generation and many electric customers also purchase natural gas from the same company that sells them electricity. In addition, there is already competition for the provision of some aspects of gas service. There is good reason to consider opening the natural gas bill rendering, remittance processing, and collections services functions (billing) so that competing gas and electric providers can choose to provide a consolidated bill for gas and electricity and so that the customers of such providers will not face duplicative charges for the billing function. In addition, most customers who purchase natural gas from entities other than the utilities now receive redundant bills from the distribution utility and the gas provider. This may be an inefficient result, where the customer only wants a single, consolidated bill yet is saddled with the cost of two bills. It may therefore be logical for the natural gas utilities to provide billing options similar to those currently offered on the electric side whether or not we make changes to the current market structure. We intend to provide a forum for parties to address

potential labor impacts associated with providing competitive billing and other services. The assigned commissioners will issue a ruling outlining the details of this forum in the near future.

2. With some differences, both PG&E and SoCalGas already offer separate rates for procurement, storage, and interstate transportation. As we continue the movement toward the broader offering of competitive services, it is important to ensure that all costs are assigned to the appropriate function. To achieve this goal, we must examine each utility's total revenue requirement and understand where each dollar should be assigned on a functional basis, whether those costs are fixed or variable, specific or common. Then, when we have determined whether and the extent to which various service components will be competitively provided, the utilities will be able to implement separate rates for those services and assure us that no charges have been left in any functional category by default.

For these reasons, we will direct the respondent utilities to file applications in which they identify the functional categories to which all costs should be allocated. Those categories must include procurement, transmission, storage, hub services, balancing, public purpose programs, revenue cycle services, and distribution. Transmission revenues and resulting rates should be divided into interstate and intrastate components. Revenue cycle service revenues and rates should separately identify costs for billing, meter provision and maintenance, meter reading and customer service, and other services provided beyond the meter.

Not all of the respondent utilities own or control natural gas storage facilities. For those that do, there appear to be four principal storage functions:

1. Providing seasonal "economic" storage for core service -- storage capacity used to hedge against price fluctuations.

2. Ensuring reliability of service for core customers -- storage capacity used by the utility to supplement flowing supplies to meet its own procurement customers' requirements during peak periods, typically during winter months.

3. Balancing-related storage -- storage capacity used to compensate for an aggregator's failure to supply the full quantity of gas that it is committed to provide.

4. Noncore firm storage -- storage capacity for which, currently, the utilities are partly or wholly at-risk.

In their applications, we will ask each respondent utility that does face storage costs to report on the amount of injection, withdrawal, and inventory that it dedicates or allocates to serving each of these functions and to propose separate rates that reflect these priorities.

These applications shall be filed no later than February 26, 1999.

Through these applications, the utilities should prepare to have separately identified costs and rates for all services no later than March 31, 2000. We believe it is critical that these rates reflect the fully-allocated costs related to the particular function being performed; that is, all costs attributable to providing that function, plus an allocation of common costs. The applications filed February 26, 1999 should therefore reflect, at a minimum, proposals to separate costs and rates using a fully-allocated methodology, in addition to any other proposal the utilities wish to advance.¹ The separate rates will only appear on

¹ In these applications the utilities need to demonstrate how all required revenues are allocated by function. The utilities have the burden of demonstrating that the information they rely upon is accurate. In some instances, they may be able to use data submitted to the Commission in the context of other proceedings. This is acceptable so long as the data produces accurate results.

bills issued on or after March 31, 2000 for those services that are being competitively offered. The Commission has previously allowed for competitively providing some services, such as the core aggregation programs offered by most respondent utilities. We emphasize, however, that we are explicitly deferring judgment on the appropriateness of allowing competition in the provision of any services, including those services about which safety or labor impact concerns have been raised. We will not make further determinations about which, if any, services should be competitively provided until we have reviewed the various reports and hearings scheduled for this summer.

Core Aggregation Limits

Our existing policies allow for limits on participation in the Core Aggregation Transportation (CAT) program. In 1990 the Commission, in Decision (D.) 90-02-040, set forth final rules for a three-year experimental CAT program to allow core customers to participate in, and benefit from, the emerging competitive gas supply market. These rules limited the program to 10% of each gas utility's total retail core demand, and required a minimum aggregated customer volume of 250,000 therms per year in order to participate in the program.² In 1994, the Commission ordered that the experimental CAT program should continue pending a more in-depth review of the program (see D.94-04-027). In 1995, in D.95-07-048, the Commission reviewed and extended the CAT program. At that time, the Commission made certain refinements to the program

²We note that, for PG&E, the core aggregation program limits are reduced. Under the PG&E Gas Accord (D.97-08-055) the 10% core load limit is lifted and the 250,000 therm-per-year aggregated minimum is reduced to 120,000 therms per year.

and ordered further unbundling of interstate pipeline demand charges from core rates; however, the original 10% participation limit and 250,000 therm-per-year minimum threshold limitations have remained.

The minimum volume threshold for program participation can be traced to the Commission's 1986 Rulemaking (R.86-06-006) into refinements for new regulatory framework for gas utilities, in which core customers were defined as those who use less than 250,000 therms per year (D.86-12-010). Core customers were also considered to have the highest priority on the system and to have no alternate fuel capacity. At that time, the Commission stated its intention

"to restrict eligibility for procurement options at this time to customers who, because of larger size and/or alternate fuel capabilities, are likely to be best equipped to participate in a competitive marketplace and make well-reasoned decisions regarding natural gas services for themselves. Another strictly secondary reason is that such restrictions would ease the utilities' administrative burdens by a reduction in the sheer volume of customers requesting information and contracts. As the marketplace develops, both these factors may become less important, and we may reconsider whether the restrictions should be reduced or eliminated."³

The origin of the 10% participation limit is more recent: in our initial decision approving the three-year CAT program, the Commission agreed with the utilities that "it is reasonable to put some limits on program participation because of the experimental nature of the program." Essentially, the CAT limits were designed to provide utilities with customer and load stability and at the same time provide an opportunity to test the competitive gas supply product.

³ 22 CPUC 2d 491, p. 505-506.

These limits also protected core customers while competitive gas supply, transportation, and storage markets developed.

The CAT program has proven to be a valuable option for participating customers by allowing core customers to consolidate their loads and purchase gas from a non-utility supplier of their choice. As the marketplace has evolved, the distinction between customers has become less clear. Indeed, as we found in 1995, "noncore customers are today distinguished from core customers only by their size, even though both core and noncore customers may be able to take advantage of competitive options" (see D.95-07-048). In the absence of a strong reason for maintaining limits, beneficial programs should be available to all utility customers. Furthermore, the utilities have now developed and are refining transaction and information systems to accommodate transportation-only transactions with both noncore and core customers.

The CAT program is eight years old, and its limits now apply to a program that is no longer experimental. The remaining distinctions between core and noncore in terms of access to competitive options should be removed. While we discuss our plans for opening up those options elsewhere in this order, here we state our intention to remove two barriers to participation in the program. We recognize that these limits are not the only impediment to a competitive core gas supply market and that removing the 250,000 therm-per-year threshold or the 10% participation limit will not by itself have a dramatic or immediate impact on the market. Rather, our intention is to remove any unnecessary restrictions on competition for core natural gas customers.

At the same time, because lifting the core aggregation program limits may expand competitive options available to residential and small commercial customers, it is imperative to enact adequate consumer protections, as discussed more fully below, prior to lifting the core aggregation limits.

For all of these reasons, we will direct the respondent utilities with core aggregation programs to file advice letters, within 30 days of the Commission issuing a natural gas consumer protection program, reflecting any tariff changes necessary to remove the minimum volume and maximum participation restrictions currently applicable to the core aggregation programs.

Consumer Protections

We agree with the DSP report, as well as many parties who addressed consumer protection issues in their comments, that consumer protections developed for the natural gas industry should be consistent, where appropriate, with protections the Commission has established for its other restructured, regulated industries. Also consistent with the electric industry, where consumer protections were in place prior to allowing for expanded competitive options in the residential and small commercial markets, we must have consumer protection in place prior to lifting the core aggregation program restrictions. Consistent with our goals in implementing recent consumer protection initiatives for electric customers, we seek to arm natural gas consumers with sufficient knowledge to make them confident participants in a competitive natural gas industry as well. This will allow us to minimize confusion for natural gas consumers, as well as identify trends in consumer abuse, and more efficiently use our own consumer resources for energy-related enforcement, prevention and mediation activities.

Our experience in the telecommunications, and - more particularly - the electric industry, suggests that the key elements of an effective, efficient consumer protection program include:

- *A screening process for market service providers.* Consumers should be confident that their chosen gas service provider can demonstrate to the Commission, at a minimum, basic levels of financial viability and ethical conduct,

as well as technical expertise or experience which qualifies them to effectively participate in the market.

- *Service Provider Registration.* According to the provisions of Senate Bill 477 (SB 477, enacted in February 1998), a prospective Electric Service Provider (except investor-owned regulated electric utilities) must provide its corporation's legal name; current telephone number and address; agent for service of process; state and date of incorporation (if any); customer contact representative; description of the services to be provided; civil, criminal, or regulatory sanction or penalty disclosure; proof of financial viability; and proof of technical and operational ability. This registration process contributes to consumer education and confidence in the choices available to them.

- *Third-Party Verification.* Independent verification of service changes can be another mechanism to assure consumers of their control in an industry with more service options.

- *An Education Program.* Natural gas consumers should be informed about the changes that have occurred and that are being considered in the natural gas industry so that they are better positioned to take advantage of the options available to them. They should also be educated and confident about their rights and recourse options in a more competitive gas industry.

- *A Process for Addressing Problems or Complaints.* If consumers do experience problems, are dissatisfied with their service or are subjected to fraudulent actions, the process to air those concerns should be clear, concise and responsive.

- *Written Notice and Disclosure.* Written notice of the prices, terms, and conditions of service, as well as written description of the customer's right to rescind the contract, should be provided to small commercial and residential customers.

We will direct the Energy Division to prepare proposed consumer protection rules within 30 days and to mail them to all parties in this docket for comment. At a minimum, these rules should address the elements outlined above. Comments will be due no later than 30 days after the proposed rules are mailed. The Commission will take appropriate action as soon as possible thereafter.

Conclusion

In this order, we set forth our expectations for undertaking and completing this rulemaking effort. In addition, we take several steps to adjust the current marketplace. We require the respondent utilities to file applications to separately identify costs and rates for all services. In addition, we begin the process of developing enhanced consumer protections for customers that choose to take gas service from a competitive provider prior to lifting restrictions on the utilities core aggregation programs.

Findings of Fact

1. There is good reason to consider opening the natural gas bill rendering, remittance processing, and collections services functions (billing) so that competing gas and electric providers can choose to provide a consolidated bill for gas and electricity and so that the customers of such providers will not face duplicative charges for the billing function.
2. As the natural gas industry continues its movement toward the broader offering of competitive services, it is important to ensure that all costs are assigned to the appropriate function.
3. The appropriate time to determine the applicability of CEQA to the development of a comprehensive natural gas regulatory strategy is after the Commission has identified a proposed market structure.
4. The minimum volume and maximum participation restrictions currently applicable to the core aggregation programs do not appear to be necessary and may have a chilling effect on the development of the core aggregation market.
5. The protections provided to consumers of natural gas should be at least as comprehensive as the protections provided to consumers of electricity.

Conclusions of Law

1. The utilities listed as respondents in the rulemaking order opening this proceeding should file cost and rate separation applications as described in this decision.

2. The motion for determination of the applicability of CEQA to this rulemaking filed by CCUE/SCGWC on April 29, 1998 should be denied without prejudice.

3. The minimum volume and maximum participation restrictions currently applicable to the core aggregation programs should be eliminated once appropriate consumer protections are in place.

4. The Commission should direct the Energy Division to develop and present proposed consumer protection rules for the gas industry.

O R D E R

IT IS ORDERED that:

1. No later than February 26, 1999, the utilities listed as respondents in the rulemaking order opening this proceeding shall file applications as described in this decision. These applications shall address separation of costs and rates for all services as discussed in this decision. The goal of this exercise is to provide a basis for ensuring that customers who elect to receive competitive natural gas services from an entity other than the utility will not be charged by the utility for those services.

2. On the basis of the Market Conditions Reports, rebuttal and comments to the reports, we intend to issue a proposed market structure decision. Based on the elements of that proposal, we will assess the applicability of the California Environmental Quality Act (CEQA) to our adoption of a final policy decision.

3. No later than 30 days after the Commission issues consumer protection rules, respondent utilities with core aggregation programs shall file advice letters reflecting any tariff changes necessary to remove the minimum volume and maximum participation restrictions currently applicable to the core aggregation programs.

4. No later than 30 days after the effective date of this order, the Energy Division shall develop and serve on all parties proposed consumer protection rules for the gas industry. These rules should include standards for being listed as a registered provider as well as criteria and procedures for removing providers from the list if they fail to adhere to applicable standards. In addition, they shall include a notice and appeal process under which a provider can contest a decision to have its name removed from the list. Parties may file comments on the proposed rules no later than 30 days after they are mailed.

5. The motion for determination of the applicability of CEQA to this rulemaking filed by the Coalition of California Utility Employees and the Southern California Gas Workers Council on April 29, 1998 is denied without prejudice.

This order becomes effective 30 days from today.

Dated August 6, 1998, at San Francisco, California.

RICHARD A. BILAS
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