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Decision 98-12-024 December 3, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA GAS COMPANY for Approval of a Long-Term Gas Transmission Service Contract with Distribuidora de Gas Natural de Mexicali, S. de R.L. de C.V. (U 904 G)	Application 97-03-015 (Filed March 10, 1997)

ORIGINAL

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FINAL OPINION

Summary

Southern California Gas Company (SoCalGas) requests Commission approval of its long-term gas transmission service contract with Distribuidora de Gas Natural de Mexicali, S. de R.L. de C.V. (DGN). Also, SoCalGas requests that the Commission not allocate the cost of exclusions, as defined in its Performance-Based Ratemaking (PBR) filing Application (A.) 95-06-002, to the DGN contract in cost allocation proceedings subsequent to the expiration of the Global Settlement term and continuing to the expiration date of the contract. And SoCalGas requests that the Commission exempt the contract from the provision of Section X of General Order (GO) 96-A that otherwise makes the contract subject to modification by the Commission during its term.

This decision: (1) grants Commission approval of the DGN transmission service contract; (2) denies SoCalGas' request for special treatment of the cost of exclusions; and, (3) grants SoCalGas' request for exemption of the contract from Section X of GO 96-A.

Background

The northern area of Mexico bordering on California has historically not had any natural gas service provided through gas pipelines. In November of 1995, the government of Mexico issued regulations that allow for licenses to be granted to private companies to construct and operate natural gas transmission and distribution pipelines in Mexico. On August 12, 1996, after a competitive bidding process, the Mexican government awarded a license for natural gas distribution in the Mexicali area to DGN.

DGN is a Mexican corporation owned as follows: (1) 30% by subsidiaries of Pacific Enterprises (other than SoCalGas or its subsidiaries); (2) 30% by subsidiaries of Enova Corporation; and (3) 40% by Proxima, a Mexican corporation not otherwise affiliated with Pacific Enterprises or Enova Corporation.

Subsequent to the issuance by the Mexican government of the license for distribution service in the Mexicali region, SoCalGas entered into negotiations with DGN for an agreement for SoCalGas to provide gas transportation service across its system to a border crossing point to be constructed at the California - Mexico border at Mexicali. Gas supplies and transportation upstream of the SoCalGas system would be the responsibility of DGN, not SoCalGas. On January 29, 1997, SoCalGas and DGN entered into an agreement (Service Agreement or contract) for this transportation service. (Exhibit No. 1.)

SoCalGas applied for and received approval of the Federal Energy Regulatory Commission (FERC) for construction of border crossing facilities and other necessary approvals to deliver gas to Mexicali pursuant to Section 3 of the federal Natural Gas Act. SoCalGas obtained FERC approval of the final location of the border crossing on May 16, 1997 (79 FERC ¶61,188). The FERC has also previously issued a declaratory order disclaiming jurisdiction to approve or regulate the rates or facilities of SoCalGas (other than the border crossing facility) that would be used to transport gas to Mexicali pursuant to the Service Agreement (68 FERC ¶61,277).

SoCalGas proceeded to construct a 14.4 mile pipeline extension (designated Line 6903) from the prior terminus of its service on Lines 6000 and 6001, to the border crossing location, and to construct the actual border crossing facilities approved by the FERC.

On July 31, 1997, SoCalGas began service to DGN at the Mexicali border crossing. DGN is still in the process of building its distribution system in the Mexicali region. Average daily volumes have reached the level of 5 to 6 MMcf/d. SoCalGas' forecast of average throughput over the life of the contract is 16 MMcf/d. The contract provides for a maximum of 25 MMcf/d for firm service.

Statutory Authority

This application was filed pursuant to Public Utilities (PU) Code §§ 451, 454, 489, and 701 and the Commission's Rules of Practice and Procedure. No change in existing rates is requested (Rule 23(l)).

Procedural Summary

On March 10, 1997, SoCalGas filed this application requesting approval of the Service Agreement. After the receipt of protests and SoCalGas' response thereto, the Commission on July 16, 1997, issued Decision (D.) 97-07-062, granting SoCalGas interim authority to serve DGN under the terms of the Service Agreement, pending a final Commission decision after evidentiary hearings. The decision made SoCalGas' charges for this service subject to refund or to surcharge retroactively from the date of a decision after hearings to the date of commencement of service.

A prehearing conference before the assigned administrative law judge (ALJ) was held on August 14, 1997. Evidentiary hearings were held on March 30 and 31, 1998. Opening briefs and reply briefs were filed by SoCalGas, Southern California Edison Company (Edison), jointly by the Southern California Utility Power Pool and the Imperial Irrigation District (SCUPP/IID),[1] by the Office of Ratepayer Advocates (ORA), by the Utility Reform Network (TURN), by the City of Vernon (Vernon), and by the City of Long Beach (Long Beach). Opening briefs were filed on May 6, 1998. Reply briefs were filed on May 20, 1998, and this matter was submitted for decision.

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[1] The members of SCUPP include the Los Angeles Department of Water and Power and the Cities of Burbank, Glendale and Pasadena.

The Gas Transportation Service Agreement (Service Agreement)

The Service Agreement between SoCalGas and DGN provides for firm service as defined in SoCalGas' tariffs. Its terms are summarized as follows: firm service is for 15,150 decatherms per day, subject to increase up to 25,200 decatherms per day on 18 months notice. Service above the firm volume may be provided on an interruptible basis. The term of the contract is for 12 years, subject to a rate readjustment clause that may be triggered by either party after five years. SoCalGas is required to file with the Commission by the end of the eleventh year of the service agreement a tariff for default service to be applicable after the twelfth year of the contract. The initial volumetric rate is 3.5 cents per therm, with annual escalation equal to an inflation index less one percentage point. The service contract provides for a minimum monthly charge of 75% of the daily minimum quantity times the number of days in the month times the volumetric rate. The service contract also provides for a minimum annual charge of $600,000 plus interest for the first five years of the contract, payable at the end of the fifth year. There is also an exit fee in the case that DGN selects another transmission service provider during the 12-year term. There are Operational Flow Order provisions, fees for imbalances beyond allowed quantities, and a provision for dispute resolution that includes binding arbitration.

The issues presented for decision by the Commission are addressed below.

Reasonableness of Service Agreement

Other than SCUPP/IID and Long Beach, no other party took a position on the reasonableness of the 3.5 cents per therm rate or the conditions of service of the Service Agreement. However, other than SoCalGas, all the parties that filed briefs had concerns regarding the allocation of the cost of exclusions to the DGN contract. That issue is addressed later.

Position of SoCalGas

SoCalGas points out that since the contract rate is 3.5 cents per therm and the customer-specific long run marginal cost (LRMC) for service to DGN is 2.1 cents per therm,[2] the contract rate easily exceeds the LRMC floor and provides a significant contribution to margin of approximately 1.4 cents per therm.

Further, SoCalGas points out that the 3.5 cent per therm rate under the Service Agreement will escalate annually at a rate equal to the Gas Utility Price Index (GUPI) less 1%, which will be at least 1.1% to 1.5% greater than for SoCalGas' rates in general for at least the next five years. According to SoCalGas, the escalation provision of the Service Agreement must, therefore, be considered reasonable in protecting the interest of other SoCalGas customers in contribution to margin.

Also, according to SoCalGas, the terms of the Service Agreement other than the 3.5 cents per therm rate are the same or less favorable to DGN than the terms of default tariff gas transportation service by SoCalGas.

SoCalGas contends that the rate under the DGN Service Agreement is as much as SoCalGas can realistically be expected to obtain in light of the competitive alternatives available to DGN. SoCalGas points to the testimony of its witness Bisi in Exhibit No.3-A, where he presented a detailed description of the cost of service from an alternative transmission provider using the El Paso system to deliver gas to Yuma, Arizona, and then constructing a new pipeline through northern Baja, Mexico, to Mexicali bypassing California. SoCalGas witness Borkovich in Exhibit No.1-A at pp.13-14 translated that cost into a range for the rate that the alternative transmission provider could offer for service to

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[2] The 2.1 cent LRMC SoCalGas calculated for service to DGN uses the 1996 BCAP Commission-adopted LRMC.

DGN at Mexicali. According to SoCalGas, the rate under the Service Agreement that SoCalGas is asking the Commission to approve in this case falls within the range for the competitive transmission provider developed by witnesses Bisi and Borkovich. Furthermore, SoCalGas argues that this gas transmission service alternative is also credible because it was the subject of an earlier application by El Paso Natural Gas Company (El Paso) at the FERC that was withdrawn only because the suspension of an earlier project to repower the Rosarito Beach electric generation station left El Paso without a contract to provide service that FERC requires as a condition of processing such an application.

Position of SCUPP/IID and Long Beach

SCUPP/IID and Long Beach argue that SoCalGas has not met its burden to show that the contract rate is reasonable. They contend that SoCalGas has: (1) insufficiently substantiated that there are competitive alternatives to justify a 3.5 cents per therm rate; and (2) SoCalGas has not shown that the Service Agreement was negotiated at arms-length.

According to SCUPP/IID, there were no competitive alternatives at the time SoCalGas negotiated the Service Agreement. Therefore, SCUPP/IID contend there is no basis for the 3.5 cents per therm negotiated rate, which is significantly lower than the rate SoCalGas charges its other wholesale customers. SCUPP/IID urges the Commission to require SoCalGas to charge DGN the "full rate," like other wholesale customers on SoCalGas' system.

Further, SCUPP/IID argue that when a competitive alternative "legitimately arises," the Service Agreement provides the means for SoCalGas to meet that situation since: (1) the Service Agreement allows DGN to ask for a readjustment in year 2002; and (2) the Service Agreement requires that DGN "communicate to SoCalGas any commercially viable competing offers for transmission service that DGN or its customers ... may receive during the term of this Agreement." Thus, SCUPP/IID contend that SoCalGas is not precluded from negotiating a competitive rate when a viable competitive alternative surfaces.

Also, SCUPP/IID argue that the Service Agreement, and especially the rate, is inherently suspect because the negotiations between SoCalGas and DGN were conducted between affiliates. SCUPP/IID point out that SoCalGas' parent, Sempra Energy, owns 60% of DGN. Furthermore, according to SCUPP/IID, the negotiators from SoCalGas were outnumbered and largely outranked by their counterparts at DGN, Enova International, and Pacific Enterprises.

Long Beach shares the same concerns as SCUPP/IID that the Settlement Agreement was not the result of arms-length negotiation since DGN is an affiliate of SoCalGas (and San Diego Gas & Electric Company (SDG&E)).

Regarding the Settlement Agreement requirement that DGN communicate to SoCalGas any commercially viable competing offers, Long Beach believes that SoCalGas' contractual right to respond will itself inhibit any potential competition. Further, Long Beach believes that as a practical matter, the Mexicali market is not likely to attract competitors, particularly since there is no "anchor tenant" in Mexicali for any competing pipeline. According to Long Beach, when a commercially viable competing offer is made to DGN, as discussed above, SoCalGas can respond. In the meantime, "to restore the integrity of an arms-length transaction," Long Beach urges the Commission to adjust the contract rate to conform to SoCalGas' offer to Tenneco on the basis of a minimum volume of 10 mmcf/d at 350 psig, since gas flows to DGN currently are well below the contract amount. According to Long Beach, such an adjustment would result in an effective contract rate of 5.5 cents per therm.

Discussion

We reject the arguments of SCUPP/IID and Long Beach that: (1) DGN had no credible gas transmission service alternatives; (2) the terms of the contract eliminate the threat from a competitive alternative; and (3) the negotiated rate of 3.5 cents per therm is unreasonable. We believe that, as argued by SoCalGas, there are several reasons to support a finding that DGN had credible transmission service alternatives and SoCalGas had to price its service to meet those alternatives.

At the time that DGN signed the Service Agreement with SoCalGas in January of 1997, there were no gas transmission pipeline facilities reaching Mexicali, whether owned by SoCalGas or by an alternative gas transmission service provider. However, at the time, there was available to DGN an alternative transmission provider who would use the El Paso system to deliver gas to Yuma, Arizona, and would construct a new pipeline through northern Baja, Mexico, to Mexicali bypassing California. As pointed out by SoCalGas, this alternative was the subject of an earlier application by El Paso at the FERC that was withdrawn only because the suspension of an earlier project to repower the Rosarito Beach electric generation station left El Paso without a contract to provide service that FERC requires as a condition of processing such an application. And El Paso's withdrawal is not the end of the matter, since, as pointed out by Vernon, the pipeline winning the bid for service to Rosarito could offer service to Mexicali as well. Also, SoCalGas witness Borkovich testified that CFE official Javier Estrada had publicly expressed his view in February of 1998 that the project to serve Rosarito will be the El Paso project.

We find no merit in the argument that the provisions in the Service Agreement discussed above mean that there is no real competitive alternative, or that SoCalGas does not have to price its service to meet the competitive alternative until some future date. If SoCalGas had initially priced its service at 5.5 cents per therm as argued by Long Beach, and given the price of available alternate fuels in Mexico and the absence of an "anchor tenant," it is unlikely there would have been a contract and SoCalGas would not have had the opportunity to reduce the price for its service at a later date. Further, the inclusion of the provision in the Service Agreement to allow SoCalGas to amend the contract to meet future competitive alternatives, and DGN's contractual obligation to notify SoCalGas of competitive alternatives, do not imply that there was no competitive alternative available to DGN. In fact, this requirement comes into play only when there is a new or improved competitive alternative available to DGN. The requirement that DGN give notice simply means that if DGN gets a better offer than the service SoCalGas is providing under the Service Agreement during its term, DGN must notify SoCalGas. This notice would only give SoCalGas an opportunity, but not a guarantee, of retaining the customer by making a competitive offer to amend the Service Agreement, subject to Commission approval.

Furthermore, as pointed out by SoCalGas, even if DGN had a bias for service from SoCalGas, SoCalGas would face a competitive threat from an alternative gas transmission provider if it could offer rates below the rate in the DGN Service Agreement. Mexican regulations require DGN to connect with any alternative gas transmission service provider that constructs a pipeline to it, and they also allow the alternative gas transmission service provider to connect customers directly in the area otherwise licensed to the local gas distributor. That is good reason for SoCalGas' rate to be competitive from the outset.

The fact that DGN is owned in part by a company affiliated with SoCalGas and in part by Enova Corporation, which is affiliated with SoCalGas, is no reason for the Commission to reject the Service Agreement. The facts about the cost of serving DGN, its competitive options, and the contribution to margin from the Service Agreement are in no way affected by the affiliation. Given the lack of any evidence inconsistent with SoCalGas' showing on these issues, there is no basis to automatically label the contract as suspect. However, that does not mean we should ignore the affiliate relationships and not give close scrutiny to such contracts.

As SoCalGas' testimony shows, DGN had a competitive alternative capable of providing gas transmission service at approximately the same rate as SoCalGas is providing under the Service Agreement. While we do not characterize the competitive alternative as one of "imminent threat of bypass," we do believe that if the Commission requires SoCalGas to serve DGN at a contract or tariffed rate comparable to the rate charged other wholesale customers, then DGN would, sooner or later, possibly in conjunction with the Rosarito power plant project, contract for service from the alternative provider at approximately the 3.5 cents per therm rate.

We are not persuaded by the arguments of SCUPP/IID and Long Beach that SoCalGas should have insisted that DGN pay the same rate charged to its other wholesale customers. DGN is in a position to receive gas transmission service at a rate below the SoCalGas tariff rates for wholesale customers. Furthermore, since the 3.5 cents per therm rate provided to DGN is clearly above the LRMC, the only impact on SoCalGas' ratepayers between service by SoCalGas and service by the alternative transmission provider is that if SoCalGas provides the service, it can offset transition costs after expiration of the Global Settlement period and possibly generate a contribution to margin that can be used to reduce the rates of SoCalGas' ratepayers. On the other hand, if DGN is served by the competitive alternative, there will be no benefit flowing to SoCalGas' ratepayers since the competing pipeline will not be located in California, and SoCalGas' ratepayers (and shareholders) will lose the added benefit of a California utility getting a foothold in providing service to the future market in Mexico. Accordingly, we conclude that the rate of 3.5 cents per therm is reasonable given the circumstances that existed at the time the contract was signed. However, there are transition cost allocation concerns, which we address below.

Exemption from the Cost of Exclusions

The principal issue in this proceeding is whether the DGN contract should be allocated the cost of exclusions[3] the same as for other wholesale customers. All parties, other than SoCalGas, oppose SoCalGas' request for exemption from allocation of these costs.

The major component of the cost of exclusions is the Interstate Transition Cost Surcharge (ITCS) discussed below.

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[3] Exclusions are generally transition type costs and were defined in the SoCalGas Performance-Based Regulation (PBR) filing (A.95-06-002) to be accounts such as Interstate Transition Cost Surcharges (ITCS), PITCO/POPCO transition costs, Catastrophic Event Memorandum Account (CEMA), Hazardous Substance Cost Recovery Account (HSCRA), Low Emission Vehicle programs (LEV), Take-or-Pay costs (TOP), Minimum Purchase Obligations (MPO), California Alternate Rates for Energy (CARE), Direct Assistance Program (DAP), Interstate Pipeline Demand Charges, and Purchased Gas Account (PGA).

The impact on rates of the projected December 31, 1997 balance of the cost of exclusions is 1.51 cents per therm for SoCalGas' existing core customers and 2.69 cents per therm for SoCalGas' existing noncore customers (retail and wholesale combined).

Position of SoCalGas

SoCalGas states that from the commencement of service to DGN on July 31, 1997, through the expiration of the Global Settlement on July 31, 1999, the incremental revenues from the DGN contract should accrue to SoCalGas shareholders[4] pursuant to the terms of the Global Settlement.[5]

For the term of the Service Agreement after expiration of the Global Settlement, SoCalGas is not proposing in this application any specific allocation between its shareholders and ratepayers of the revenues from the Service Agreement. SoCalGas states that the treatment of risk/reward for the overall level of noncore revenues, including from service to Mexico, for the period after expiration of the Global Settlement has yet to be addressed by the Commission. Therefore, SoCalGas contends it would not be appropriate to make such a policy decision in a case such as this one that involves only about $2 million in annual revenues.[6]

However, in this proceeding, SoCalGas is proposing that it not be held at risk for recovering from DGN a rate that would cover long-run marginal cost (LRMC) plus the cost of exclusions,[7] if that sum exceeds the price of service to DGN from a competitive alternative. SoCalGas argues that it should not be held at risk to recover from gas consumers in Mexico, the costs associated with

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[4] Except that the revenues should also be counted towards possible sharing with ratepayers through the NCRMA if SoCalGas' total noncore revenues exceed the Global Settlement's "caps" for noncore revenue in the last two 12-month periods of the Global Settlement into which service to Mexicali falls.

[5] The Global Settlement was approved conditionally in D.94-04-088 and in final form in D.94-07-064. The full text of the settlement is an appendix to D.94-07-064.

[6] As estimated on average over the life of the contract by SoCalGas.

[7] Except for the cost of company-use gas for transmission and unaccounted-for gas.

past commitments that were made solely to fulfill SoCalGas' obligation to serve California customers. Furthermore, according to SoCalGas, if the Commission holds SoCalGas at risk to recover more than a competitive rate for service to Mexico, there will be no reason for SoCalGas to contract to provide such a service. SoCalGas points out that if it declines to provide service because of a loss to shareholders, even though there would be a net contribution to margin, then SoCalGas' ratepayers will be worse off.

Position of TURN

TURN is not persuaded by SoCalGas' argument that since revenues under the DGN contract are greater than the LRMC, there will be revenue for sharing between shareholders and ratepayers. TURN points out that until the expiration of the Global Settlement, since SoCalGas is fully at risk for noncore revenues, there will be no revenue to share with customers until after July 31, 1999, at the earliest.[8] TURN contends that even after expiration of the Global Settlement, any sharing of revenues would presumably occur through the PBR sharing mechanism, which is based on overall revenue. Thus, revenues from the DGN contract, assuming there were any, could flow to shareholders to make up for losses elsewhere. TURN believes it is entirely speculation to presume that ratepayers would actually receive any revenues from the contract. And, TURN points out that SoCalGas' contention that there will be revenues for sharing does not account for the cost of exclusions that will not be paid, if SoCalGas' request for exemption from these costs is granted.

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[8] However, TURN agrees that the Global Settlement provides a variance cap on noncore revenues; if the cap is exceeded, there could be revenues to share with customers.

TURN disputes SoCalGas' argument that the existence of an alternative provider required SoCalGas to negotiate a discounted rate with its affiliate. TURN points out that the Commission has provided SoCalGas the means to compete with actual bypass threats to avoid uneconomic bypass when it occurs.

TURN argues that SoCalGas' request to exempt the DGN contract from the cost of exclusions is directly contrary to Commission policy. TURN notes that the Commission has consistently held that ITCS costs, the largest portion of the cost of exclusions, may not be discounted (D.93-11-021, 55 CPUC2d pp. 97, 101). Therefore, TURN contends that if SoCalGas offers a contract rate that does not recover revenues sufficient to recover ITCS and other transition costs, the company's shareholders must make up the difference.

Further, TURN argues that it is not the Commission's responsibility to make the DGN contract competitive for SoCalGas. TURN contends that if SoCalGas' shareholders are not able to profit from this contract, then they should not enter into it.[9] TURN submits that the suggestion that the Commission should force other ratepayers to subsidize the utility's revenues in competitive markets is grossly unfair and contrary to the policies of this state. According to TURN, SoCalGas' shareholders stand to benefit in a number of ways from this contract, since the merged entity that owns Pacific Enterprises and Enova (Sempra), owns 60% of DGN.

TURN states that in D.97-12-088, the Commission recognized the risk to both utility customers and the competitive market from utility transactions

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[9] TURN points out that according to the contract between SoCalGas and DGN, if the Commission assigns ITCS and other exclusions to this contract, that increase will be passed on to DGN, not absorbed by SoCalGas' shareholders.

with affiliates. To protect against the risk of harm, the Commission adopted separations and reporting requirements applicable to transactions between utilities and affiliates. TURN argues that SoCalGas has provided no basis for exempting transactions with DGN from the rules adopted in D.97-12-088. TURN contends that even if the Commission accepts SoCalGas' characterization that this contract resulted from "arms-length" negotiations, the Commission cannot ignore the potential for self-dealing in the provision of service and enforcement of contract terms. Thus, TURN submits that if the Commission approves this contract, it should specifically require SoCalGas to comply with the affiliate transaction rules.

Position of ORA

ORA shares TURN's concerns regarding SoCalGas' request for special treatment of the cost of exclusions.

ORA argues that the SoCalGas request runs counter to long-standing Commission policy against the discounting of ITCS as set forth in the Capacity Brokering Decision, D.91-11-025, and in several Expedited Application Docket (EAD) decisions. ORA notes that in D.91-11-025, the Commission stated: "The ITCS shall be a volumetric surcharge that shall apply to noncore customer services and shall serve to recover various interstate pipeline costs. The ITCS shall not be subject to discounting." (*Id.* at Appendix B, p. 18.)

ORA points out that between 1993 and 1996, Pacific Gas and Electric Company (PG&E) and SoCalGas entered into about 40 EAD discount transportation contracts with noncore customers with the stated intent of preventing uneconomic bypass. The Commission approved these contracts, but also changed various contract terms and provided clear guidance on the issue of transition costs and ITCS costs in particular:

"Contrary to PG&E's allegation, we have not adopted a policy of allowing for the discounting of the transition costs that make up the ITCS in any of our existing orders or resolutions. Rather, the existing rule, as set forth by the Commission's Capacity Brokering Decision, is one that prohibits the discounting of the ITCS. (D.91-11-025, Appendix B, p. 18 (slip op.).) There are no subsequent Commission decisions or resolutions which have eliminated this prohibition, which will apply when capacity brokering is implemented.

"Rather, we intend to apply the ITCS in a nondiscriminatory manner, on an equal-cents-per-therm basis."

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"The discounting of the transition costs which make up the ITCS would trigger the reallocation of transition costs, so that noncore customers who enter into discounted contracts with PG&E would not be paying transition costs on an equal-cents-per-therm basis. Therefore, this reallocation would be inconsistent with our expressed intention to have transition costs allocated on equal-cents-per-therm basis, and in a nondiscriminatory manner." (D.93-07-059, 50 CPUC2d 470, 471.)

"DRA is correct, however, that we have prohibited discounts to the ITCS. D.93-06-094 found that the ITCS is not subject to discounting in EAD contracts. We will direct SoCalGas to amend the contract with Tehachapi accordingly. In response to concerns raised at the workshop, we herein clarify that shareholders or the contracting customer must pick up 100% of the ITCS if it is not included in the contract as a cost which is in addition to the rates presented for our consideration in these proceedings. That is, the difference between the contract rate and the prevailing LRMC will not be applied as a 'credit' for the ITCS. We have approved the various contracts in the EAD proceedings after analyzing ratepayer risks using the contract price. Consistent with our past decisions on this matter, ratepayers will not assume any additional costs

> associated with the recovery of the ITCS." (D.94-02-044, 53 CPUC2d 281, 285.)

Thus, ORA points out that the Commission has clearly and consistently supported a policy where the ITCS was not subject to discounting. According to ORA, if exceptions were made to this rule, it was made on the condition that shareholders of the utility offering the discount would be 100% at risk for any such discount.

> "However, in order to protect the other ratepayers and to assure that the ITCS costs will still be allocated in a nondiscriminatory manner, on an equal-cents-per-therm basis, the contracts will be approved only if PG&E does not collect from the other ratepayers the ITCS costs allocated to services for the customers in these four contracts, in any way, shape or form. Accordingly, we will permit these contracts to allow for the possible discounting of the ITCS if and only if PG&E's shareholders bear one hundred percent (100%) of the risk for any shortfalls resulting from the discounting of the ITCS associated with the four contracts.
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> "We intend to implement this condition for each of the four contracts by modifying D.93-06-094, in the manner set forth below. We emphasize that the exception to the prohibition against the discounting of the ITCS carved out in this decision applies only to these four contracts. By this decision, we do not intend to adopt a policy which permits the discounting of the ITCS for all contracts approved under the EAD procedure, or to change the prohibition against the discounting of the ITCS set forth in our Capacity Brokering Rules. (D.91-11-025, Appendix B, p. 18 (slip op.).) Also, today's decision in no way affects our policy of allocating the ITCS even-handedly, on an equal-cents-per-therm basis. It merely shifts any shortfalls due to the possible discounting of the ITCS associated with the four contract to PG&E's shareholders, and not to the other ratepayers." (D.93-07-059, 50 CPUC2d 470, 473, 474.)

ORA argues that if SoCalGas is allowed to discount ITCS costs and other exclusions costs for the DGN contract, it should only be done at shareholder expense, and SoCalGas should be ordered to include the full DGN volumes in its next Biennial Cost Allocation Proceeding (BCAP) for cost allocation and rate design purposes. According to ORA, this will help insure that the Commission's general policy of having all customers pay transition costs can be achieved, and verified.

Position of SCUPP/IID

SCUPP/IID argues that DGN is a wholesale customer and should be treated like other wholesale customers on SoCalGas' system. SCUPP/IID points out that all other SoCalGas wholesale customers (e.g., Long Beach, Southwest Gas) are served under their respective tariffs and pay the cost of exclusions. Therefore, SCUPP/IID urges the Commission to not ignore: (1) the Commission's decision to adopt a revenue-based PBR mechanism for SoCalGas rather than a rate-based PBR mechanism; and (2) the Commission's longstanding policy that all ratepayers are responsible for stranded investment costs, including HSCRA costs and PITCO/POPCO transition costs.

In the alternative, SCUPP/IID recommends that the Commission require SoCalGas shareholders to be responsible for 100% of the ITCS costs not included in the Service Agreement.

Position of Long Beach

Long Beach opposes any preferential treatment of DGN, relative to other wholesale customers. Long Beach contends that the DGN Service Agreement should be allocated exclusions costs in the same manner as Long Beach and SDG&E.

Long Beach states that it has been a critic of SoCalGas' practice of brokering its interstate capacity subject to minimum bids and SoCalGas' claims that its capacity prices are set at market prices. Long Beach argues that if SoCalGas' capacity prices represent market prices, then DGN should be indifferent to using SoCalGas' released capacity. Long Beach contends that for DGN to use other capacity and seek an exclusion from the allocation of ITCS costs is to add insult to injury.

According to Long Beach, SoCalGas has failed to prove that competitive considerations warrant its proposed treatment of the cost of exclusions. Also, according to Long Beach, SoCalGas has failed to show that DGN customers with liquid propane gas alternate fuel would not pay the additional costs. Long Beach also points out that meanwhile, DGN's service is not competitive with high sulfur fuel oil, even with the cost of exclusions removed from the rates.

Long Beach believes that underlying this issue is a principle regarding the relative responsibility to discount as between a retail service provider and its wholesale supplier. In this instance, SoCalGas apparently is willing to have its customers absorb 100% of the discount necessary to retain or gain throughput; however, SoCalGas was not quite so generous when the retail provider was Southwest Gas, not a SoCalGas affiliate. In that instance, SoCalGas was willing to absorb only 27% of the required discount.

Long Beach argues that if the Commission approves SoCalGas' proposal, the Commission also should state that it is SoCalGas' responsibility to absorb 100% of any discounts necessary for all of its wholesale customers to retain or gain throughput. Long Beach submits that SoCalGas should not be allowed to offer more favorable terms to its affiliate customers.

Position of the City of Vernon

Vernon states that it expects to complete its own municipal gas distribution system this summer. When that happens, Vernon will become, like DGN, a new wholesale customer of SoCalGas. As a result, Vernon has a strong interest in the policies that the Commission applies in evaluating SoCalGas' service to DGN.

Vernon argues that SoCalGas has not borne its evidentiary burden of demonstrating why an exception should be made for its affiliate from the Commission's otherwise strict rule against discounting the cost of exclusions. Vernon contends that exempting the DGN contract would violate Commission policies requiring that all beneficiaries of the new competitive natural gas regime must bear their appropriate share of the transition costs of attaining that new market structure. According to Vernon, nothing about DGN or its own competitive situation qualifies for an exemption.

Vernon disputes SoCalGas' argument that failure to approve discounted rates, to assure that DGN continues to elect service by SoCalGas, threatens SoCalGas and its ratepayers with uneconomic bypass by other pipeline providers who may first serve DGN. Vernon submits that SoCalGa's has been granted by this Commission more than adequate means within its service territory to defend itself against uneconomic bypass. According to Vernon, SoCalGas need not be authorized to provide discounted service to its affiliates outside its service territory to protect its ability to collect its revenue requirement inside its service territory. Vernon points out that SoCalGas has protected itself contractually and has included in its agreement provisions which tend to protect itself from such bypass by its affiliate DGN. Therefore, Vernon contends that the Commission need not add a new layer of protection for SoCalGas' shareholders at the expense of SoCalGas' California ratepayers and unaffiliated wholesale customers.

Vernon argues that this application should be viewed as nothing more or less than SoCalGas' proposal of an Expedited Application Docket (EAD) contract for a customer in Mexico, with the differences that (1) the utility proposes that the discount be borne in the form of ratepayers losing potential contributions to the cost of exclusions instead of requiring shareholders to be at risk for recovery of these costs, as is required for EAD contracts inside California, (2) that the recipient of the discount is a utility affiliate, unlike other California EAD discount recipients, (3) that there has been no explicit calculation of the positive ratepayer contribution to margin that would result from the contract, and (4) that there has not been any showing of imminent uneconomic bypass of facilities for which ratepayers are at risk.

According to Vernon, SoCalGas should only be permitted to offer discounts outside California under the same terms as it offers them inside California (and not under terms that are more disadvantageous to California ratepayers and less risky to SoCalGas shareholders), as long as it is using any facilities subject to this Commission's jurisdiction. Vernon submits that if SoCalGas seeks to discount its DGN service, SoCalGas should do so at its shareholders' risk, in the same manner that it discounts its noncore service within its service territory.

However, Vernon believes that DGN can reasonably be excused from costs that relate solely to retail customers, but only if and to the extent that other wholesale customers are also excused from them. According to Vernon, these would include low-income ratepayer assistance costs and low-emission vehicle costs, as these programs offer no benefit to DGN, and DGN and other wholesale customers may have the responsibility to support similar programs in their own service areas.

Position of Edison

Edison states that its interest in this proceeding is related to the cost impact that SoCalGas service to DGN will have on other SoCalGas customers, especially costs to electric generators. To the extent that costs to electric generators are increased, the Power Exchange (PX) price will be increased, thereby ultimately raising the cost to Edison's electric customers.

Edison acknowledges that there has to be an appropriate balance between ratepayer and shareholder benefits when SoCalGas acquires new load. However, Edison believes that exempting the DGN contract from the cost of exclusions, especially ITCS costs, would not provide existing customers with the potential benefits that are supposed to inure when new load is served by the utility.

Edison agrees that during the Global Settlement, SoCalGas' shareholders are at risk for any underrecovery of noncore revenue requirement. Unless the variance cap is exceeded, ratepayers are not affected by increases (or decreases) to noncore throughput during the Global Settlement period. For this reason, Edison does not take issue with SoCalGas' decision to charge DGN a rate that excludes the cost of exclusions typically paid by wholesale customers <u>during</u> the Global Settlement period. It is the period <u>after</u> the Global Settlement, which coincides with the bulk of years the DGN contract will be in effect, that Edison takes issue with SoCalGas' proposal to exempt the Service Agreement from the cost of exclusions.

Edison argues that for the period after the Global Settlement, the DGN Service Agreement should be allocated the same cost of exclusions that would be adopted for any new wholesale customer of SoCalGas, including the ITCS and PITCO/POPCO costs that other wholesale customers of SoCalGas are required to pay. According to Edison, either DGN, SoCalGas' shareholders, or a combination of the two, should pay these costs for the volumes of gas SoCalGas transports to DGN.

Further, Edison argues that the Commission should keep in mind that the contract is a 12-year agreement and, absent an inappropriate reallocation of interstate pipeline costs in which ITCS costs are shifted from core to noncore customers, the cost of exclusions should drop significantly from current levels while, at the same time, the DGN rate is continually escalating. Thus, according to Edison, under the most probable scenario of market and regulatory conditions that should exist during the term of the DGN Service Agreement, net revenues should be robust even if SoCalGas' request for exemption from the cost of exclusions is denied. Also, according to Edison, the Commission should note that SoCalGas presented no evidence of the forecast level of the cost of exclusions during the DGN contract term to support its claim that including them would be detrimental.

Edison believes that it is important for the Commission to maintain its policy that new customers connecting to SoCalGas' system be responsible for ITCS and PITCO/POPCO costs. Edison notes that the only customers exempt from paying ITCS are Enhanced Oil Recovery (EOR) customers because they typically have contracts that predate the Commission's current policy on the ratemaking treatment for negotiated long-term contracts. According to Edison, location of a customer outside of the United States does not justify an exemption to this policy. Nor, according to Edison, should the Commission be persuaded to exempt the DGN Service Agreement because sales under the contract are relatively minimal. Edison contends that gas demand in Mexico is expected to grow and, with such growth, the potential benefits to both Mexico and California are expected to increase. Edison believes that this case is extremely critical, in that if the Commission exempts the Service Agreement from allocation of ITCS and PITCO/POPCO costs, SoCalGas may claim such an exemption is precedent for future sales in Mexico when gas demand is increased. Therefore, Edison urges the Commission to not be distracted by the location of the DGN project or the amount of sales to DGN, and to find that for the policy reasons cited above, DGN is not exempted from ITCS and PITCO/POPCO costs.

Discussion

We conclude that SoCalGas' request that the DGN contract be exempt from allocation of the cost of exclusions should be denied. Equity dictates that the Commission allocate an equivalent amount of the cost of exclusions to new SoCalGas customers, whether located in the United States or Mexico. Specifically, PITCO/POPCO and ITCS transition costs result from earlier Commission decisions that permitted customers to procure their own natural gas supplies from nonutility sources and enabled the brokering of interstate pipeline capacity. These decisions resulted in increased competition, more customer choice, and reduced gas prices. DGN will certainly be able to avail itself of these benefits by purchasing its own gas supplies and interstate pipeline capacity upstream of SoCalGas' system. Exempting DGN from these transition costs would, in effect, provide DGN a free-ride on the backs of existing ratepayers who have paid and are still paying for SoCalGas' past utility commitments. Without this customer commitment to pay utility transition costs, it is doubtful that deregulation of the California natural gas industry could have proceeded, in which case DGN would not now be able to avail itself of competitive market choices. If DGN does not pay its proportionate share of these charges, SoCalGas' shareholders should make up the difference.

Further, we believe that it is important for the Commission to maintain its policy that new customers connected to SoCalGas' system be responsible for ITCS and PITCO/POPCO costs. As stated above, the only customers exempt from paying ITCS are EOR customers because they typically have contracts that predate the Commission's more current policy on the ratemaking treatment for negotiated long-term contracts.[10] Accordingly, we find no justification for an exemption from this policy.

Like any other new noncore customer that is physically connected to SoCalGas' system, DGN will be able to purchase its own gas supplies and interstate pipeline capacity upstream of SoCalGas' system as a result of the Commission's decision that permitted customers to procure their own natural gas supplies and the brokering of interstate pipeline capacity. We conclude that along with other wholesale customers, DGN should therefore pay its fair share of utility transition costs, and its location outside the United States does not justify a change in our policy.

Furthermore, SoCalGas shareholders are the primary, if not the sole, beneficiaries of DGN revenue during the Global Settlement period. In the post-Global Settlement period, SoCalGas shareholders should continue to reap meaningful rewards even if the cost of exclusions is allocated to the DGN contract. And as Edison witness Burkholder and Vernon witness Beach testified, when the DGN contract is evaluated over its entire term, shareholders are more than likely to receive revenues. The DGN contract is a 12-year agreement during which time the cost of exclusions is expected to drop significantly from current levels while, at the same time, the DGN rate would be continually escalating.

SoCalGas presented no evidence on the forecasted level of the cost of exclusions over the life of the contract. We are not persuaded by SoCalGas' argument that if the Commission allocated the cost of exclusions to the DGN contract, the same as for other wholesale contracts, there would be no reason for

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[10] As pointed out by Edison, the exemption granted for Mandalay Steam Generating Station was because of the threat of imminent bypass and SoCalGas' shareholders were required to make up the ITCS costs not recovered.

SoCalGas to contract with DGN because the contract will produce a loss to shareholders even though it would produce a net contribution to margin.[11]

In summary, there is no reason for the Commission to deviate from its policy that ITCS is not subject to discounting. If exceptions are made to this rule, shareholders of the utility offering the discount are 100% at risk for the shortfall.

Treatment of Revenues and the Cost of Exclusions

On July 16, 1997, the Commission issued D.97-07-062, granting SoCalGas interim authority to serve DGN under the terms of the Service Agreement, pending a final Commission decision after evidentiary hearings. The decision made SoCalGas' revenues for this service subject to refund or to surcharge retroactively from the date of a decision after hearings to the date of commencement of service. And in this decision, we now approve the DGN Service Agreement and conclude that the contract should be allocated the cost of exclusions the same as for other wholesale customers.

Because of the Global Settlement, the treatment of revenues from the DGN Service Agreement, and the accounting treatment for the cost of exclusions must be analyzed with respect to two distinct time periods.

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[11] Whether or not the contract rate would exceed the sum of long-run marginal cost (LRMC) plus ITCS over the life of the contract is not certain and is not even knowable at this time. Vernon witness Beach testified that he expected the total transition cost (including ITCS) level to fall shortly to 0.5 cents per therm. If this were true, LRMC plus ITCS would be less than 2.6 cents, and clearly less than the 3.5 cent contract rate. However, any forecast necessarily speculates on the unknowable future allocation by the Commission of ITCS between core and noncore customers. Furthermore, ITCS will end with the expiration of SoCalGas' interstate pipeline contracts in 2005/2006, while the DGN Service Agreement continues until at least July 31, 2009.

The first period is from the commencement of service to DGN on July 31, 1997, until expiration of the noncore throughput risk provisions of the Global Settlement on July 31, 1999. Under the Global Settlement, SoCalGas took on all risk/reward[12] with respect to noncore throughput at the level set by the Global Settlement (1991 recorded throughput, with specified adjustments) for a period ending July 31, 1999. This risk/reward meant that if SoCalGas' noncore throughput fell below the Global Settlement volumes, SoCalGas would absorb not only the shortfall with respect to base margin, but also the shortfall with respect to recovery of the cost of exclusions allocated to noncore customers in their rates over the Global Settlement volumes. The same shareholder risk/reward exposure was provided for on the upside, subject to the sharing "cap" which was provided for at p. 9 of the Global Settlement and was detailed at p. 21 of the Implementation Appendix. (See D.94-07-064.) Thus, for the period covered by the Global Settlement, there are no issues related to the allocation of revenues or the cost of exclusions related to the DGN Service Agreement.

After expiration of the Global Settlement period on July 31, 1999, SoCalGas shareholders are no longer entitled to retain all incremental noncore revenues.[13] At that time, some or all of the net revenues from the DGN Service Agreement can be allocated by the Commission to reduce the rates of other SoCalGas customers. Also, the cost of exclusions would be reflected "above-the line."

A decision in this proceeding on the allocation of DGN revenues would set a precedent for the risk/reward treatment for all noncore throughput. That issue

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[12] Except for EOR customers, and except for the "cap" or sharing mechanism on upside noncore revenue potential.

[13] For this purpose of the Global Settlement, "noncore" includes "wholesale" service.

is too important to be resolved in this case which involves only one relatively small noncore transportation contract.

Furthermore, even if the Commission took no further action to adopt a specific allocation of benefits for the post-Global Settlement period, SoCalGas customers would still automatically benefit. This is because the net revenues from the Service Agreement would contribute to an increase in SoCalGas' overall earnings, which are subject at least through December 31, 2003, to the Performance Based Ratemaking (PBR) earnings sharing mechanism that allocates as much as 75% of the incremental earnings to ratepayers (D.97-07-054, pp. 39-41.)

Since SoCalGas' 1998 Biennial Cost Allocation Proceeding (BCAP) will address the transition to post-Global Settlement regulation, and the DGN Service Agreement will not have any revenue effect until the expiration of the Global Settlement, we conclude that the allocation of net revenues between shareholders and ratepayers for the DGN Service Agreement should be addressed in SoCalGas' 1998 BCAP.

Exemption from General Order 96-A

SoCalGas requests that the Service Agreement be exempted from the portion of Section X of GO 96-A that would make the contract subject to modification by the Commission after its approval in this application.[11]

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[11] Section X of GO 96-A requires that all contracts contain substantially the following provision:

> "This contract shall at all times be subject to such changes or modifications by the Public Utilities Commission of the State of California as said Commission may, from time to time, direct in the exercise of its jurisdiction."

SoCalGas states that in the 1980's, the Commission first authorized, in the context of long-term contracts with EOR customers, the waiver of the provisions of GO 96-A that otherwise make contracts subject to the Commission's continuing jurisdiction to amend them even after original Commission approval. Also, SoCalGas states that in D.92-11-052, which authorized the Expedited Application Docket (EAD) process for long-term contract approval, the Commission adopted the general principle that long-term service agreements so approved should be exempt from these provisions of GO 96-A.

According to SoCalGas, the Commission has consistently waived this provision of GO 96-A in a long series of EAD decisions.[15] SoCalGas acknowledges that this application is not technically an EAD proceeding. However, SoCalGas argues that there is even more reason to grant its request for waiver in this application than in an EAD since this application has gone through full-blown evidentiary hearings not applicable in an EAD.

Further, SoCalGas argues that the reasons for waiver of GO 96-A in the present circumstances are very powerful. According to SoCalGas, California needs to establish itself as a reliable partner on commercial terms with Mexico if it is to generate increased future revenues from gas transportation service by California gas utilities to the California - Mexico border. SoCalGas contends that the waiver is important to obtaining the trust of Mexico in California as a utility business partner. SoCalGas urges the Commission to treat its affiliates just as fairly as the Commission would treat any other legitimate market participant.

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[15] SoCalGas cites the following decisions: D.93-06-096; D.93-10-072; D.94-02-044; D.94-04-080; D.95-01-040 (as modified by D.95-09-101); D.95-01-041; D.95-04-063; D.95-05-006; D.95-06-047; D.95-09-029; D.95-09-096; D.95-09-097; D.95-09-102; D.95-11-005; D.95-11-006; D.95-11-019; D.95-11-048' D.96-02-053; D.96-04-019; D.96-06-004; D.96-09-096; D.97-03-005; and D.97-04-071.

SoCalGas' request for the waiver is opposed by several parties.

SCUPP/IID argues that the waiver should not be granted because DGN is affiliated with SoCalGas. However, SCUPP/IID cites no Commission legal or policy precedent that requires legitimate utility affiliates to be treated differently from other market participants.

TURN argues that because the Commission has rarely exercised its powers under GO 96-A to modify a contract after initial approval, DGN as well as Mexican customers and governmental authorities should not be concerned if the Commission declines to waive this right. However, TURN does not explain why the Commission should be concerned about waiving a right it is unlikely to exercise.

Also, TURN argues that the waiver should not be granted since the Commission recently declined to waive this provision of GO 96-A for discounted *core* contracts.

TURN's argument is not on point. In D.98-01-040, the Commission expressed concerns about free riders signing up for a new program offering negotiated discount contract rates and optional tariffs to core customers. We stated: "This is a new program and (it) should be subject to critical review on an annual basis to ensure that customers do not game the system." In contrast, the DGN contract does not involve the kind of concerns addressed in D.98-01-040.

Further, TURN argues that the waiver should not be granted because unlike EAD contracts, the DGN contract does not involve the threat of imminent bypass. We disagree. Imminence of bypass is a condition for the availability of the EAD process, not for availability of waiver of GO 96-A.

ORA argues that if the waiver is granted, SoCalGas and DGN could then agree to modify the Service Agreement to remove Section 6 of the agreement, which states that modifications of the Service Agreement are subject to

Commission approval. ORA claims that SoCalGas and DGN could then agree between themselves to modify substantive provisions of the Service Agreement, such as rates, without prior Commission approval.

We are not persuaded by ORA's argument. This provision of GO 96-A has nothing to do with the power of a utility and a customer to agree to contractual changes. Rather, this provision of GO 96-A, unless waived by the Commission, gives it the power to impose contract changes after initial approval, even if the changes are opposed by one or both of the parties to a service agreement. Waiver of this provision of Section X of GO 96-A will not eliminate the requirement that if the contracting parties agree on a change in a long-term service agreement, it still must receive prior Commission approval to become effective.

SoCalGas has acknowledged that it is obliged under GO 96-A to obtain prior Commission approval for any material modification of the Service Agreement after initial Commission approval, and that this obligation would survive even if the Commission waived its right to unilaterally impose changes to the contract.

We believe that SoCalGas' request for waiver of GO 96-A should be considered on its own merits: (1) aside from GO 96-A, the Commission has other tools to address any problem that may arise from this contract; (2) as discussed below, the Commission has in place affiliate transaction rules which would apply to the DGN contract; and (3) the DGN contract has been the subject of two days of evidentiary hearing at which seven expert witnesses were subject to cross-examination. Therefore, we will grant SoCalGas' request to waive the portion of Section X of GO 96-A that gives the Commission unilateral power to modify this contract.

Affiliate Transaction Rules

In D.97-12-088, the Commission adopted rules for affiliate transactions.

On August 6, 1998, the Commission issued D.98-08-035, which among other things granted in substantial part a petition for modification of the affiliate transaction rules filed on January 15, 1998, by SoCalGas with respect to the temporary use of energy utility employees by affiliated companies.

By letter dated October 7, 1998, Sempra Energy informed the Commission that in light of the Commission's action in D.98-08-035, SoCalGas believes it is no longer necessary to seek exemption from the affiliate transaction rules of its contract to serve DGN-Mexicali. Therefore, Sempra on behalf of SoCalGas asked to withdraw its request for exemption made in SoCalGas Advice Letter 2661. Sempra agrees that the contract between SoCalGas and DGN-Mexicali would be subject to the affiliate transaction rules as modified by the Commission.

We agree. Sempra's request to withdraw SoCalGas' request for exemption, included in Advice Letter 2661, should be granted. The DGN contract will be subject to the affiliate transaction rules as modified by D.98-08-035.,

Revenue Sharing with SDG&E

There is one issue raised by SoCalGas' application as originally filed that no longer needs to be addressed by the Commission in this decision. As part of their cooperative efforts to develop business to provide gas transmission service over their systems to the California - Mexico border, SoCalGas and SDG&E had entered into a "revenue sharing" agreement with respect to the allocation of revenues between the two companies from any service they might provide to the border for consumption in northern Mexico, including the Mexicali area. The revenue sharing agreement required Commission approval to become effective, and it had been submitted by SoCalGas for approval as part of this application.

At the opening of hearings on March 30, 1998, SDG&E and SoCalGas stated for the record their intent to amend the revenue sharing agreement to exempt service to the Mexicali region from its scope, and SoCalGas withdrew its request for Commission approval of the revenue sharing agreement in this application. Therefore, all of the revenues from service to DGN under the Service Agreement are available for allocation solely between SoCalGas shareholders and SoCalGas customers.

SoCalGas represents to the Commission that since March 30, 1998, SoCalGas and SDG&E have in fact modified the revenue sharing agreement to eliminate service to Mexicali from its scope. The two parties did not terminate the revenue sharing agreement entirely, and they would seek Commission approval of the modified revenue sharing agreement in a future proceeding in which it would have application.

We agree that the SoCalGas/SDG&E revenue sharing agreement is not an issue in this proceeding.

Rate Treatment of Mexicali Extension

SCUPP/IID requests that the Commission explicitly find that the 14.4 mile pipeline extension to the border and border crossing are incremental projects dedicated solely to servicing Mexicali. SCUPP/IID states that SoCalGas has completed 14.4 miles of 12-inch diameter pipeline that extends its existing Line 6001-2 from Dogwood & Dannenberg terminus to the border, as well as a 500-foot length of 16-inch diameter pipeline that crosses the border to the service point with DGN. SCUPP/IID points out that these facilities have been added to SoCalGas' system solely to provide service to DGN. The total cost of these incremental facilities was $4.4 million.

We agree with SCUPP/IID that these facilities are incremental projects dedicated solely to serving loads in Mexicali. During the Global Settlement period, these facilities should be treated as "below-the-line investments" consistent with the Commission's directives regarding the exclusion from rate base of SoCalGas' investments in Lines 6900, 6902, and 325. (See D.97-07-054, mimeo., p. 79.)

SCUPP/IID argues that in the post-Global Settlement period, if the Commission wishes to consider alternate rate treatment for the Mexicali extension, it should adopt an incremental rate treatment similar to that authorized for the PG&E Expansion and Wheeler Ridge projects. According to SCUPP/IID, these facilities should not be rolled in with the remainder of SoCalGas' rate base.

We will reserve the post-Global Settlement rate treatment of the Mexicali extension for the 1998 BCAP proceeding.

Further, SCUPP/IID requests that the Commission set forth the rate treatment for any upstream system expansion that might be required by Mexicali loads. SCUPP/IID states that while SoCalGas may have a current maximum obligation of about 25 MMcfd for firm deliveries of natural gas to DGN, the contract terms provide that this obligation can be modified by "mutual agreement between the parties."

SoCalGas witness Borkovich testified that no such expansion is planned in the next 15 years. Further, any contract for SoCalGas to provide service to DGN in excess of 25 Mmcfd would require SoCalGas to request and receive Commission approval. Therefore, we will defer any decision on allocation of the costs of any upstream facility additions to a time when the relevant facts and circumstances are placed before us.

Section 311 Comments

The ALJ's proposed decision was mailed for comments on October 19, 1998. Comments were timely filed by Edison, Long Beach, SoCalGas, SCUPP/IID, and Vernon.

Reply comments were timely filed by SoCalGas, SCUPP/IID and TURN.

We have reviewed the comments and made changes to the proposed decision where appropriate.

Findings of Fact

1. The Commission on July 16, 1997, issued D.97-07-062, granting SoCalGas interim authority to serve DGN under the terms of the Service Agreement pending a final Commission decision after evidentiary hearings.

2. On July 31, 1997, SoCalGas began service to DGN at its Mexicali border crossing.

3. Evidentiary hearings were held on March 30 and 31, 1998, where SoCalGas' Service Agreement with DGN was subject to examination.

4. Pursuant to the Service Agreement, SoCalGas will charge DGN an initial contract rate of 3.5 cents per therm.

5. SoCalGas justified its initial contractual rate of 3.5 cents per therm on the basis of the rate that could be offered to DGN by an alternative gas transmission service provider.

6. The LRMC cost for SoCalGas to serve DGN is approximately 2.1 cents per therm.

7. The contract rate of 3.5 cents per therm meets the Commission's requirement that all contracts should, at least, recover the utility's long-run marginal cost (LRMC) to serve the customer.

8. SoCalGas states that the DGN contract rate of 3.5 cents per therm will provide a significant contribution to margin. In that regard, SoCalGas is assuming that the Commission will grant SoCalGas' request that the DGN contract be exempt from allocation of the cost of exclusions.

9. For there to be any contribution to margin, based on the current LRMC plus the cost of exclusions, the rate to DGN would have to be more than 4.8 cents per therm.

10. Several parties argue that the Commission should require SoCalGas to charge DGN the same rate as would be charged its tariffed wholesale customers. Including the cost of exclusions, that rate would be, at least, 4.8 cents per therm.

11. The Commission's policy is that all customers, except EOR customers, should pay their fair share of the cost of exclusions, unless there is a finding that there is a "threat of imminent bypass."

12. The facts in this case do not support a finding of a threat of imminent bypass.

13. At the time SoCalGas negotiated the Service Agreement, there were credible alternative service providers available to DGN in the event SoCalGas did not offer DGN a contract rate that was competitive with the rate that could have been offered by an alternative provider.

14. Regarding SoCalGas' request that the DGN contract be exempt from allocation of the cost of exclusions, it is DGN's physical connection to SoCalGas' system, not DGN's location in Mexico that is material as to whether DGN should be treated the same as other wholesale customers and be allocated the cost of exclusions.

15. For purposes of allocating the cost of exclusions, it is reasonable to treat DGN the same as any wholesale customer.

16. Since DGN will benefit from the results of this Commission's gas industry restructuring decisions to the same extent as any new wholesale customer within California, the DGN contract should not be exempt from any of the same rate components such customers would pay, including the cost of exclusions.

17. Subject to the Noncore Revenue Variance Cap and sharing mechanism in the Global Settlement, during the Global Settlement period SoCalGas is at risk for all noncore throughput, thus there is no issue with DGN contract revenues

through July 31, 1999. Likewise, these would be no allocation to the DGN contract of the cost of exclusions during that period.

18. After the Global Settlement period is concluded, the DGN contract should be allocated costs similar to that of a wholesale customer, including the cost of exclusions.

19. The sharing of net revenue from the DGN Service Agreement and the accounting for the cost of exclusions for the post Global Settlement period should be addressed in SoCalGas' 1998 BCAP.

20. SoCalGas presented no evidence on the forecasted level of the cost of exclusions over the life of the contract.

21. During the 12-year term of the DGN contract, the cost of exclusions should drop significantly from current levels while, at the same time, the DGN rate will be increasing due to application of the escalation factor included in the Service Agreement.

22. Even if SoCalGas' shareholders are held responsible for recovering from DGN a rate that would cover the LRMC plus the cost of exclusions, there is a reasonable expectation that SoCalGas' shareholders and ratepayers will receive positive benefits over the 12-year term of the contract.

23. When the contract is evaluated over its entire term, shareholders are likely to receive benefits, even if the cost of exclusions is fully allocated to the DGN contract.

24. The 14.4 mile pipeline extension and Mexicali border crossing was added solely to provide service to DGN.

25. SoCalGas requests that the Commission waive Section X of GO 96-A. Granting the waiver would prohibit the Commission from unilaterally imposing changes to the Service Agreement.

Conclusions of Law

1. SoCalGas' request to exempt the DGN contract from full allocation of the cost of exclusions should be denied.

2. The DGN contract should be allocated the full cost of exclusions the same as any new contract for a wholesale customer located in California.

3. If SoCalGas decides to continue to serve DGN, and the sum of the LRMC to serve DGN plus the cost of exclusions exceeds the contract rate, SoCalGas shareholders should be held responsible for the shortfall in the full allocated cost of exclusions.

4. The revenue sharing agreement between SoCalGas and SDG&E is not an issue in this proceeding.

5. In this proceeding, we do not address how the net revenue from DGN should be allocated between SoCalGas ratepayers and shareholders after the Global Settlement expires. This issue should be decided by the Commission in the 1998 BCAP in the context of overall shareholder ratepayer allocation of risk for noncore throughput.

6. SoCalGas' request for waiver of a portion of Section X of GO 96-A should be granted for the reasons set forth above.

7. Wavier of this provision of Section X of GO 96-A will prohibit the Commission from unilaterally imposing changes in the Service Agreement, but it will not eliminate the requirement that if the contracting parties agree on a change to the Service Agreement, it still must receive prior Commission approval to become effective.

8. Essentially, in this decision we only approve the DGN Service Agreement and decide the issue of whether the full cost of exclusions should be allocated to the contract after the Global Settlement expires. SoCalGas must decide whether

or not to exercise its right to cancel the Service Agreement if the terms of Commission approval are unacceptable.

9. The cost of the 14.4 mile pipeline extension should be allocated in its entirety to service to DGN.

10. The DGN contract should be subject to the affiliate transaction rules as modified by D.98-08-035.

FINAL ORDER

IT IS ORDERED that:

1. The long-term gas transportation service agreement between Southern California Gas Company (SoCalGas) and Distribution de Gas Natural de Mexicali, S. de R.L. de C.V. (DGN) is approved subject to the requirement that after the Global Settlement expires on July 31, 1999, the DGN contract shall be allocated the full cost of exclusions, the same as other SoCalGas wholesale contracts.

2. SoCalGas' request that the DGN contract not be allocated the cost of exclusions is denied. Shareholders shall be responsible for any shortfall in the cost of exclusions after the Global Settlement has expired.

3. During the term of the Global Settlement, the incremental revenues resulting from the DGN contract shall accrue to SoCalGas' shareholders.

4. The cost of the 14.4 mile pipeline extension shall be allocated in its entirety to the cost of providing service to DGN.

5. The post-Global Settlement allocation of net revenues between shareholders and ratepayers from the DGN Service Agreement shall be addressed in SoCalGas's 1998 Biennial Cost Allocation Proceeding.

6. The cost of exclusions applied to the DGN Service Agreement shall be the same as for other wholesale contracts.

7. For the gas transportation service agreement approved herein, the provision of Section X of General Order 96-A, which would otherwise require that this contract "at all times [to] be subject to such changes or modifications by the Public Utilities Commission of the State of California as said Commission may, from time to time, direct in the exercise of its jurisdiction," is waived. All modifications to the Service Agreement agreed to by DGN and SoCalGas, shall be subject to Commission approval before taking effect.

8. The DGN contract shall be subject to the affiliate transaction rules as modified by Decision 98-08-035.

9. Application 97-03-015 is closed.

This order is effective today.

Dated December 3, 1998, at San Francisco, California.

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

I will file a concurrence and partial dissent.

/s/ JESSIE J. KNIGHT, JR.
Commissioner

I will file a concurrence.

/s/ JOSIAH L. NEEPER
Commissioner

APPENDIX A

LIST OF APPEARANCES

Applicant: Glen J. Sullivan, Attorney at Law, for Southern California Gas Company.

Interested Parties: Morrison & Foerster, by Jerry Bloom, Attorney at Law, for California Cogeneration Council; John Burkholder, for Beta Consulting; James F. Walsh, Attorney at Law, for San Diego Gas & Electric Company; Rufus Hightower, for the City of Pasadena; Cameron McKenna, LLP, by Michael S. Hindus, Attorney at Law, for US Generating Company; Gloria M. Ing, Attorney at Law, for Southern California Edison Company; Jim Mordah, for Imperial Irrigation District; Theresa Mueller, Attorney at Law, for The Utility Reform Network; Bernard V. Palk, for City of Glendale; Jones, Day, Reavis & Pogue, by Norman A. Pedersen and Susanne E. Stamey, Attorneys at Law, for Southern California Utility Power Pool/Imperial Irrigation District; Robert L. Pettinato, for Los Angeles Department of Water & Power; Patrick J. Power, Attorney at Law, for City of Long Beach; Ronald V. Stassi, for City of Burbank; Catherine Yap, for Southern California Utility Power Pool; Edson & Modisette, by Carolyn Baker, Attorney at Law, for Chevron USA; Crossborder, Inc., by Tom Beach and Brady & Berliner, by John Jimison, Attorney at Law, for City of Vernon; Wright & Talisman, by Catherine George, Attorney at Law, for Enron; Robert Weisenmiller, for MRW & Associates; and Judy Pau, for El Paso Natural Gas Company.

Office of Ratepayer Advocates: Joseph DeUlloa, Attorney at Law.

(END OF APPENDIX A)

Commissioner Jessie J. Knight Jr. Concurring and Dissenting in Part:

As someone who has worked for many years in international business and international policy, I fervently lend my support to this contract between Southern California Gas Company (SoCalGas) and Distribuidora de Gas Natural de Mexicali (DGN) that serves to establish a mutually beneficial business relationship between California and Mexico. As the first of what may be many other transportation contracts to customers south of California's border, I consider this contract a "win-win." I concur with all aspects of the decision, with the exception of the treatment of costs termed "exclusions."

In the event that contract revenues are less than costs, the decision requires shareholders to bear this increment. I would have preferred that the disposition of this increment be deferred to the same Biennial Cost Allocation proceeding (BCAP) where the allocation of contract revenues between shareholders and ratepayers will be decided. In my mind, this would yield a more symmetrical regulatory outcome. Instead, the treatment in this order places 100% of the excess costs on shareholders, while deferring a decision on what amount of benefits are allocated to shareholders. Furthermore, a legitimate argument can be made that because the DGN contract is market-based, SoCalGas cannot raise the contract price to cover all of the "exclusion" costs. If one accepts the argument that ratepayers benefit from DGN paying part of these costs, as I do, it is acceptable to consider allocating some portion of excess costs to ratepayers. As I have argued before in other cases, the Commission and stakeholders should give credence to long term economic benefits that surely accrue on projects of this type for both ratepayers <u>and</u> shareholders. To ignore this impact short changes the analysis, and short changes ratepayers by not giving recognition to the fact that this incremental throughput helps to lower system costs. Moreover, the Commission's regulatory scheme should not penalize the shareholders of SoCalGas to the point that they do not pursue opportunities for throughput growth, especially those in the international marketplace, which spread system costs over a potentially larger customer base. In the long-run, contracts such as this one promise to bring great benefits to California ratepayers and should be encouraged by the Commission.

Dated December 3, 1998 at San Francisco, California.

/s/ Jessie J. Knight, Jr.
Jessie J. Knight, Jr.
Commissioner

A.97-03-015
D.98-12-024

Commissioner Josiah L. Neeper, Concurring:

I support the contract between Southern California Gas Company (SoCalGas) and Distribuidora de Gas Natural de Mexicali (DGN) and have no problem voting for this decision. I will discuss my thinking with regard to one aspect of the decision.

In the event that contract revenues are less than costs, the judge's order requires shareholders to bear this increment. As with Commissioner Knight, I would have preferred that disposition of this increment be deferred to the same Biennial Cost Allocation Proceeding where the allocation of contract revenues between shareholders and ratepayers would be decided. In my mind, this would have presented a more symmetrical regulatory outcome. Instead, the treatment in this order places 100% of the excess costs on shareholders, while deferring a decision on what amount of benefits are allocated to shareholders. I also agree with Commissioner Knight that because the DGN contract is market-based, SoCalGas cannot raise the contract price to cover all of the "exclusion" costs. I had drafted an alternate at one point that would allocate some portion of excess costs to ratepayers. Generally, the Commission's regulatory scheme should not penalize SoCalGas' shareholders to the point that they do not pursue throughout growth which spread system costs over a larger customer base. In the long-run, contracts such as this one promise to bring great benefits to California ratepayers and should be encouraged.

However, I did not submit this alternate because ALJ Patrick's Proposed Decision correctly states existing Commission policy, which is to allow ITCS discounting only if the shareholders pick up the discount. This policy is robust and well-articulated. While I can envision other ways of approaching the issue, nothing convinced me that this case was an appropriate vehicle for reconsideration of this policy. However, I may wish to see the Commission review this policy in a future case, such as the Gas Strategic Plan, that has a broader industry perspective.

/s/ JOSIAH L. NEEPER
JOSIAH L. NEEPER
Commissioner

San Francisco, California
December 3, 1998

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Jessie J. Knight Jr.

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Commissioner

A.97-03-015
D.98-12-024

H-9

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Josiah L. Neeper

JOSIAH L. NEEPER
Commissioner

San Francisco, California
December 3, 1998