PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2668
March 12, 1986

RESOLUTION

SOUTHERN CALIFORNIA GAS COMPANY (SoCal Gas). ORDER AUTHORIZING EMERGENCY CONTRACT FOR PURCHASE AND SALE OF NATURAL GAS FOR UTILITY ELECTRIC GENERATION (UEG).

BACKGROUND

By Advice Letter No. 1610, dated March 5, 1986, and pursuant to Section 491 of the Public Utilities Code, SoCal Gas requests a temporary deviation from the rates for service and sales volumes of gas provided under contracts now in effect for service in accordance with Rate Schedule GN-5, GN-5A, G-60, G-61 and Resolution No. G-2664 to Southern California Edison Company, Department of Water and Power, Burbank Public Service Department, Glendale Public Service Department, Pasadena Water and Power Department, Imperial Irrigaion District, Long Beach Gas Department and San Diego Gas & Electric Company.

Customers served under these schedules have informed SoCal Gas, and SoCal Gas believes, that the continuing precipitous drop in the world oil prices makes it uneconomical to use natural gas for utility electric generation at the currently authorized rates.

SoCal Gas proposes to provide service to the existing UEG customers served under Rate Schedules GN-5, GN-5A, G-60, G-61 and Resolution No. G-2664 based on a spot market price of $2.05 per MMBtu for equivalent volumes plus a margin return of not less than $.20 per MMBtu, totaling $2.25 per MMBtu under a special contract.

The term of the proposed contract is for thirty days. The contract provides that the customer will use natural gas and not oil during the contract term unless required in its judgement to meet an operating emergency or its testing requirements. Customers may terminate service under this contract anytime during the period of March 19 through March 21, 1986. Termination would be effective seventy-two hours after receipt of notice of termination.

SoCal Gas has sought and obtained reductions in the unit cost of its spot market and long-term supply purchases. Although purchased gas costs have not fallen as rapidly or as far as have fuel oil prices, the trend is indisputably and significanty downward.

Service will continue on this basis for the term of the contract. It is further provided that during Episode Days as defined in Rate Schedule GN-5, the Episode Day rate then in effect will be applicable to Southern California Edison Company, Department of Water and Power, Burbank Public Service Department, Glendale Public Service Department and Pasadena Water and Power.

POSITION OF PARTIES

Protests and comments were received by the Evaluation and Compliance Division from the Public Staff Division (PSD), the City of Long Beach (Long Beach), Toward Utility Rate Normalization (TURN), San Diego Gas and Electric Company (SDG&E), Utility Consumers Action Network (UCAN) and California Manufacturers Association (CMA). Their protests and comments are summarized below.

PSD recommends rejecting SoCal's Advice Letter No. 1610 and proposes some alternatives. PSD states that:

"The Commission should view the request for immediate action with a healthy dose of skepticism. Although there may be times where it is appropriate to authorize almost immediate rate changes without notice and any meaningful opportunity for parties to be heard, current circumstances facing SoCal and its suppliers hardly warrant special emergency treatment. Last minute filings such as Advice Letter 1610 must be viewed as attempts to pressure this Commission into acting without fully exploring possible repercussions for all of SoCal's ratepayers." and, "The Commission's action with regard to this advice letter filing will send a signal to gas suppliers and producers which will have long range ramifications. The Public interest demands that the Commission ensure that the right signal is sent. It is therefore imperative that the Commission ensure that its decision on this advice letter provides the most long term benefits to all ratepayers. The Commission should not allow itself to be stampeded into precipitous action."

PSD also states that the proposed two cent per therm margin is too low and that the margin should be a minimum of 4.5 cents per therm. Additionally, as an alternative, PSD proposes that the Commission adopt a partial fixed margin recovery by means of a Monthly Demand Charge for the UEG customers concerned herein. This margin would be broken down into two parts, i.e.: three cents per therm as part of the commodity rate and the remaining 1.5 cents collected through a monthly demand charge.

The City of Long Beach is a wholesale customer of SoCal and also resells natural gas to Southern California Edison Company for UEG at its Alamitos generating station located in Long Beach. The Agreement with Edison, which runs until January 1, 1988, requires Long Beach to supply gas at a rate no greater than the rate paid by Edison to SoCal for equivalent service in the Los Angeles Basin area. Under Schedule G-60, Long Beach currently pays SoCal $3.28 per decatherm for gas. Under its Agreement with Edison, and due to PUC Resolution No. G-2664, Long Beach was required to re-sell that gas to Edison for $2.80 per decatherm, a loss to the City of $.48 per decatherm. Accordingly effective February 11, 1986, Edison left Long Beach's system in favor of the $2.80 rate of SoCal after Long Beach advised Edison that it could not sell gas to it for $2.80.

The volume of gas which Long Beach was selling to Edison until February 11, 1986 was 40,000 Mcf per day. According to the City, the loss of this margin will drastically affect the rates of the remaining customers on Long Beach's system, or cause Long Beach to operate at a substantial loss for so long as this situation continues.

Since SoCal is asking the PUC to maintain for it a profit margin of $.20, Long Beach is seeking to maintain a like margin of profit of $.20 on its electric generation sales. This would be accomplished by an equivalent volume G-60 UEG sales rate of $2.05. While this price would not recover their entire margin, it would give some basis for continued Edison sales.

TURN submitted comments and a limited protest after having made extensive studies of SoCal's gas supply sources, and the probability of lower natural gas prices to meet the price competition from oil.

TURN thus supports SoCal's request with certain express caveats, namely:

(a) If the advice letter is approved the Commission should adopt a special temporary incentive mechanism, which among other things would require a 3.0 cents per therm margin.

(b) The subject contracts for SoCal's UEG customers be considered as a strictly temporary emergency deviation from normal ratesetting policies.

Further TURN urges the Commission to call a halt to the process of regulation by advice letter, for such issues, and reserve any further rate design for hearings in the Spring CAM proceedings of SoCal.

SDG&E commented that it applauds SoCal Gas' responsiveness to the changing fuel markets and its attempts to structure rates so as to retain service to Utility Electric Generation (UEG) customers. SDG&E strongly believes that it is in the best interests of all ratepayes to retain sales to the UEG market. SDG&E is concerned, however, over one aspect of Advice No. 1610. According to SDG&E, SoCal Gas' proposed UEG sales rate of $2.25 per MMBtu, which incorporates a margin return of not less than $.20 per MMBTU, is not reflective of the existing rate structures for SoCal Gas' diffrent UEG customers. For example, SDG&E currently provides 100% of its margin contribution to SoCal Gas by way of its G-61 capacity charge. Were SDG&E to contribute $.20 per MMBtu of margin return to SoCal Gas under the Advice No. 1610 proposal, the result would be a double margin contribution from SDG&E. SDG&E, therefore, respectfully submits that its applicable rate under this proposal should be $2.05 per MMBtu commodity cost as identified in Advice No. 1610.

SDG&E's fuel situation at present is such that a gas price of $2.25 would exceed current oil prices and, therefore, would not be sufficient to induce SDG&E to gain purchase power plant gas. At $2.05 however, SDG&E would seriously consider service under this proposal. SDG&E also pointed out that, at present, this proposal is not fully comparable to a firm alternate fuel offer. The second sentence in Paragraph 2 of SoCal Gas' draft contract greatly limits SoCal Gas' commitment to deliver this gas and requires the UEG customers to purchase fuel oil to cover the contigency of a loss of this gas supply.

Utility Consumers' Action Network (UCAN) supports the Southern California Gas Company attempt to retain gas sales to the electric generation market. UCAN supports SDG&E's position that both the present G-61 capacity charge and the proposed $.20 per MMBtu charge should not be paid by SDG&E for electric generation use.

The California Manufacurers Association (CMA) states that it has in previous Commission proceedings supported the concept of idexing low priority gas rates to fuel oil, and has also stated its position that it supports gas sales to customers at incremental cost if such pricing retains gas load advantageous to the system as a whole.

"Such support, however, its conditioned on the development of an evidentiary record in a fomal proceeding. Such a proceeding, by its nature can provide answers to basic factual and policy questions that the advice letter process cannot. The Commission in its decision can rely on such an evidentiary record to ensure that the proposed action is advantageous to the gas system as whole."

CMA questions both the facts and policies contained in SoCal's Advice Letter 1610 that should be answered in a formal proceeding, either the Consoldiated Adjustment Mechanism in May or an other expedited forum, if the Commission so desires. However, acceptance of Advice Letter 1610 will prejudge certain issues, such that other ratepayers are irreparably damaged.

In addition to the concerns raised by PSD, TURN and the City of Long Beach, CMA also raised two other concerns, namely:

1. Since fuel oil prices are moving down with unheard of velocity, will this offering achieve the desired result of maintaining UEG gas sales?

2. Are Edison's ratepayers economically indifferent to a contract at $2.25 MMBtu, if fuel oil prices fall further?

Each of the protestants has made very valid points concerning this filing. However, California ratepayers would be better off if the weighted average cost of natural gas were reduced so as to benefit all other classes of SoCal's customers instead of UEG customers only.

DISCUSSION

Last month, when we approved SoCal's initial request for a "special emergency contract" for UEG sales, we stated that our intent was to provide SoCal's suppliers with a "grace period" in which to react to the declining fuel oil market by adjusting their commodity rates to levels competitive with alternate fuel prices. We noted that our approval of extensions to the special UEG rate would depend on whether the pipelines' PGA (Purchased Gas Adjustment) filings of new commodity rates effective April 1, 1986, would allow these long-term supplies to be marketable to fuel-switching customers. We share the disappointment with which our staff and TURN have reacted to these filings. It is clear that the pipelines have lost further ground in the competition with fuel oil. TURN has provided what we find to be a compelling illustration of this fact by calculating the average commodity costs of all gas (both spot and long-term) flowing through the El Paso and Transwestern systems, using the assumption of 60% long-term gas and 40% spot at 100% load factor. Because both systems are unlikely to be full simultaneously during the low demand spring period, these average commodity costs represent the lowest feasible average prices, assuming 60% take from full priced system supplies.

Using the filed April 1 commodity rates for long-term gas and SoCal's forecast of spot gas at $2.05/MMBtu, the April 1 average commodity costs are $2.37/MMBtu for El Paso and $2.33/MMBtu for Transwestern. These averages are significantly above the required UEG rate of $2.25/MMBtu. Last month, when we approved Resolution G-2664, similar calculations yielded average rates of about $2.70/MMBtu, below the necessary UEG rate of $2.80/MMBtu. Thus, it is no surprise that SoCal now asks us to continue to target virtually all spot gas to the UEG market, and to accept a decrease in the margin contribution from UEG sales from $0.50/MMBtu to $0.20/MMBtu. We concur with TURN that, absent other possibilities, this strong evidence that gas from El Paso and Transwestern is no longer marketable to UEG customers would leave us with just one option: to allow the UEG load to fuel switch in order to send the strongest possible signal to the producers that their prices are too high. However, we are aware that both pipelines are attempting to reduce their average commodity costs by increasing the amount of their system supply which they release onto the spot market. We recognize that this approach may have longer-term benefits such as the reduction in the pipelines' take-or-pay liabilities. Essentially what the pipelines are doing amounts to reducing full-priced system supply purchases below the 60% level of commitment which SoCal has generally followed since its entry into the spot market, but which this Commission has never ratified.

We note that last month in Resolution G-2664 we questioned SoCal's adherence to a 60% level if long-term supplies purchased at that level were not marketable. Today we expect SoCal to take whatever actions necessary to ensure that on April 1 the gas

supplied to it through the El Paso and Transwestern systems is, on the average, marketable to UEG customers. The "grace period" ends March 31, for SoCal as well as for its pipeline suppliers. After that date it is our intention that the UEG market be served without any extraordinary targeting of spot gas. In return we will approve the special UEG rate of $2.25/MMBtu, subject to several conditions discussed below. We remind SoCal that it has been our policy that SoCal's management, not this Commission, is responsible for determining and justifying the appropriate level of purchases from its long-term suppliers and the corresponding premium, above spot prices, that it is willing to pay for such supplies.

We also share the concerns of staff and TURN regarding the $0.20/MMBtu margin contribution that we are being asked to accept. We concur wholeheartedly with the staff's contention that this level of margin contribution is too low, and we agree that we need to move in the direction of establishing minimum margin contributions from all customer classes. However, such decisions will be made more appropriately in the context of our ongoing gas OII (I. 84-04-079); we will address such issues in a decision on policy and procedure in that case which is on our agenda for the meeting of March 19, 1986. In the meantime, we concur with TURN that only the present drastic circumstances of rapidly falling oil prices, and our incomplete transition to a new regulatory framework, justify our acceptance of such a nominal margin contribution.

Furthermore, we acknowledge that the risks and burdens of the present circumstances have not fallen evenly on all parties. Gas producers have had to accept dramatically lower prices, pipelines are discounting rates to maintain throughput, and ratepayers have seen margins pared to the bone on low priority sales. Only the utilities themselves have been well-insulated from recent events. This situation is going to have to change in the near future.

Regardless, utility management does have a substantial ability to influence prices in today's markets; for example, SoCal could increase the margin available on UEG sales through hard bargaining with its spot gas suppliers. TURN has proposed that we accompany our approval of Advice Letter 1610 with a modest incentive program designed to provide SoCal with an incentive to realize at least a $0.30/MMBtu margin on UEG sales over the course of this special contract. While such incentive mechanisms are worthy of consideration, we do not know at this time whether TURN's incentive proposal properly balances the potential risks and benefits to SoCal. Furthermore, we do not believe it would significantly effect SoCal's behavior as it would only be in effect for about 30 days. For now, we will not adopt TURN's incentive procedure but will advise SoCal once again that their actions are subject to reasonableness review. We expect SoCal to take whatever action is necessary to put continued downward pressure on spot gas prices to bring the margin contribution

through the special UEG commodity price of $2.25/MMBTU to a minimum of 30 cents by April first. If it fails to do so, at our regularly scheduled meeting of April 2, we may choose to impute the 30 cent contribution in the $2.25 special rate for the balance of the 30 day period of this order.

Both SDG&E and the City of Long Beach have asked for a special contract rate of $2.05/MMBtu from SoCal. SDG&E claims that it need not make a margin contribution, because it continues to pay 100% of its margin contribution to SoCal in its demand charge. Although a significant portion of SDG&E's and the City's margin contribution is made through demand charge payments to SoCal, SoCal does incur other costs such as pipeline demand charges on behalf of SDG&E and the City. SoCal currently recovers these costs through its G-60 and G-61 commodity rates. While the required margin contribution that should be recovered in SoCal's wholesale commodity rates is certainly less than it would be absent the demand charges, we are not prepared to say that it should be zero as proposed by SDG&E and the City. Obviously this is an issue that needs to be explored further. At this time, we will not allow SDG&E or the City of Long Beach a $2.05/MMBtu rate. In future proceedings we will continue to look at this issue of demand charges and how such charges effect contributions that are made through commodity rates. Finally, we find merit in TURN's suggestion that the balancing accounts for SoCal's wholesale customers must be "trued up" so that SoCal's customers do not subsidize discount sales to the UEG load of SoCal's wholesale customers.

We have discussed some of the minimum steps that need to be taken in order to decrease SoCal's cost of gas to levels competitive with current oil and gas supply conditions. In the short-term, we believe that if adequate steps are taken to bring down the cost of both spot and long-term gas supplies, as outlined above, then the resulting margin contributiion and benefits to all ratepayers of lower costs from long-term supplies will be adequate justification to keep Edison on the system.

PSD has argued that a 45 cents/MMBTU margin contribution is the minimum contribution to fixed costs by UEG customers that should be approved. This is based on PSD's analysis of SoCal's cost of service allocation studies. Such margin contributions are impossible in today's fuel markets unless SoCal can obtain spot gas at $1.80. This illustrates a fundamental problem with our current rate design in today's competitive environment. Our current rate design attempts to recover fixed costs through commodity rates. This does not appear to be sustainable in the long-run. We agree with the PSD that it is necessary to recover some portion of SoCal's fixed costs through a monthly demand charge for UEG customers. Such demand or standby charges would be paid regardless of whether the UEG customer was burning gas or oil. It would assure that some minimum contribution to fixed costs was made by UEG customers who receive significant benefits

by being connected to SoCal's fixed transmission and distribution system. We note that SDG&E currently pays such a demand charge.

We are aware that SoCal and SCE are currently negotiating a longer-term (6 months to 1 year) solution to the fuel switching problem so that we are not faced with emergency advice letter filings on a monthly basis. As part of these negotiations, we expect SoCal and SCE to negotiate an interim demand charge which would go into effect as soon as possible, and to bring the combined contribution to margin in the special commodity rate and the negotiated demand charge to the 45 cent contribution to margin urged by staff. Similar negotiations with other UEG customers should also take place. Ultimately, we expect that the issue of the appropriate level of demand charges will be an issue in SoCal's upcoming CAM proceeding. In the meantime, the negotiated demand charges will provide SoCal with some reasonble fixed cost recovery. In the event that negotiations fail, we may impose a temporary demand charge on UEG customers until the matter can be resolved in evidentiary hearings.

FINDINGS

1. SoCal's customers have indicated that, based on the current price of oil, they intend to burn oil instead of natural gas in their electric generating plants unless they can obtain natural gas at a price of $2.25 per MMBtu during the period March and April 1986.

2. This emergency deviation is required to avoid the certain loss of market that would occur absent approval of this special contract. Should utility electric customers discontinue use of natural gas for electrical generation, the fixed costs associated with the resulting revenue loses would fall on higher priority customers.

3. It is reasonable for SoCal Gas to provide service for a limited time to existing customers under Rate Schedules GN-5, GN-5A, G-60, G-61 and Resolution No. G-2664 at $2.25 per MMBtu.

4. We expect SoCal to take all steps reasonably possible to bring down both their long-term and spot gas supply costs.

5. As part of its longer-term negotiations with UEG customers, we expect SoCal to negotiate interim demand charges to be instituted as soon as possible.

6. All UEG customers have already executed contracts. If the City of Long Beach desires to participate, it must execute a contract within 5 days.

7. Notice of the following order did not appear on the Commission's agenda as required by the Government Code. This matter is an emergency issue in that oil prices are falling precipitously and without the special contract in effect, a greater fixed cost and financial burden would have to be placed on SoCal Gas' residential and other high priority customers. Extensive noticing of this fiing has taken place through individual mailings to the General Order 96-A list and the parties of record in OII 84-04-079.

THEREFORE;

1. Under the provisions of Public Utilities Code Sections 451 and 491, SoCal Gas is authorized to enter into the "Contract For The Sale of Natural Gas For Utility Electric Generation" that is the subject of SoCal Gas Advice Letter No. 1610, filed March 5, 1986. The terms of each contract shall not exceed thirty days.

2. SoCal Gas shall take whatever actions necessary to ensure that on April 1 the gas, both spot and system supplies, which it purchases through the El Paso and Transwestern systems is, on the average, marketable to SoCal's UEG customers.

3. SoCal Gas shall make every effort to secure a margin contribution of $0.30 per MMBtu from UEG sales by April 1, 1986.

4. The San Diego and Long Beach requests for a UEG rate of $2.05 per MMBtu are hereby denied.

5. Consistent with existing tariff GN-5, GN-5A, GN-60 and GN-61 schedules these rates shall not apply on Episode Days and existing rates will apply.

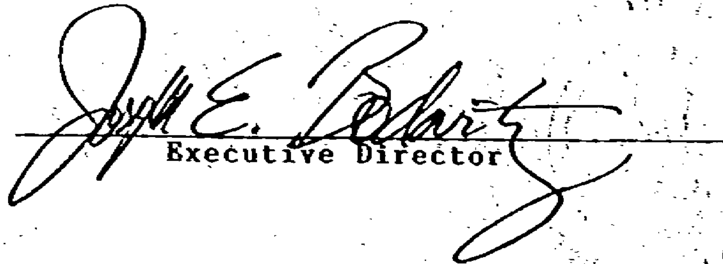
6. The above advice letter and contract form shall be marked to show that they were authorized for filing by Commission Resolution G-2668.

7. Each qualified customer who enters into a contract with SoCal Gas pursuant to this Resolution will be required to furnish an affidavit attesting to the forecasted purchase price of oil for utility electric generation and SoCal Gas will provide copies of the affidavits to the Commission.

8. This Resolution shall be served on all parties to the Commission's ongoing Gas Long Term Rate Design proceeding in I. 84-04-079.

9. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission on March 12, 1986. The following Commissioners approved it:



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