PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2674
May 7, 1986

RESOLUTION

SOUTHERN CALIFORNIA GAS COMPANY (SoCal Gas) REQUESTS AUTHORIZATION FOR APPROVAL OF A ONE-YEAR CONTRACT BETWEEN SoCal Gas AND SOUTHERN CALIFORNIA EDISON (SCE) FOR THE SALE OF NATURAL GAS FOR UTILITY ELECTRIC GENERATION (UEG).

SUMMARY

By Advice Letter 1619-G, filed March 31, 1986, SoCal Gas has submitted an Agreement For The Purchase, Sale and Delivery of Natural Gas Fuel For Electric Generation which includes a $4.5 million per month demand charge with a three-tier commodity rate schedule to SCE. SoCal Gas states that the rapid decline in world oil prices and the continuing unstable oil prices have caused it to seek this contract to maintain SCE and other UEG customers on its system. The term of the proposed contract is one year.

DISCUSSION

The commodity rates and volumes under the agreement are establish in three tiers as follows:

- Tier I - SoCal Gas is obligated to deliver, or offer to deliver and SCE is required to take or pay for, each month a minimum quantity equal to 52.5M Decatherms of gas each day. In the event of undertakes by SCE in any month, it will have the right to make up during the immediately following month. The following month's quantities will be first allocated to fulfill that month's Tier I requirements. Any quantities taken in excess of those requirements will first be allocated to the prior month's undertakes. The rate per Decatherm will be SoCal Gas' actual monthly weighted average cost of gas, excluding all short term purchases and pipeline demand charges and/or fixed costs, plus 50 cents per MMBtu.

- After SCE has purchased all volumes of Tier I gas it may request either Tier II or Tier III gas.

- <u>Tier II</u> - SCE, may request, and SoCal Gas will use its best efforts to obtain, sufficient volumes at the lowest available price through short term purchases to deliver to SCE and others in the same customer class, the customers' Tier II requirements. SCE will inform SoCal Gas by the 20th calendar day of each month of its appropriate requirements for the next calendar month. SoCal Gas will inform SCE by the 25th day of the month of its projected incremental gas cost for the following month and the approximate quantity that will be available at that price. SCE will then notify SoCal Gas within 48 hours how much gas Edison estimates it will purchase. The projected cost to Edison will be calculated based on Edison's estimated volumes. However, during the delivery month, SoCal Gas will notify SCE of any changes in the projected cost, if such projected cost is expected to change by more than 5 cents per Decatherm. For all Tier II gas, SCE will pay SoCal Gas' actual incremental gas supply cost plus 15 cent per Decatherm.

- <u>Tier III</u> - If SCE requests Tier III gas, SoCal Gas is obligated to deliver up to 157.5M Decatherms per day upon request. The rate per Decatherm shall be SoCal Gas' actual monthly weighted average cost of gas supplies excluding all short term purchases and pipeline demand charges and/or fixed costs.

Gas delivered to Edison under Tiers I and III of this contract will be designated as a new highest Priority 3 service, and curtailed only after all other Priority 3 customers are curtailed. An advice letter amending Rule 23, Shortage of Gas Supply, Interruption of Delivery and Priority of Service, will be filed shortly. All volumes under Tier II shall be at SoCal Gas' lowest priority of service. In addition, SoCal Gas shall be excused of its obligation to deliver Tier I and III gas when SoCal Gas determines that these volumes are necessary to meet the demands of its Priority 1 and 2 customers. At the end of each month a determination will be made to verify that all Tier I and requested Tier III volumes have been made available to SCE. SCE shall pay only for the total quantity of Tier I gas available each day of the month. If the entire quantities of Tier I and requested Tier III gas are not made available by SoCal Gas to SCE for and reason, the monthly demand charge will be recalculated for the month in acordance with the following formula:

$$\$4{,}500{,}000 - \left(\frac{\text{Dth Curtailed}}{Q}\right) \text{ times } \$4{,}500{,}000$$

(Where Q is equal to the quantity of gas in Decatherms SoCal Gas was obligated to deliver during that month under Tier I and requested to deliver under Tier III).

If the Commission takes any action that substantially modifies or alters the terms and/or conditions of this agreement, either SoCal Gas or SCE shall have the right within 30 days of the effective date of the Commission's order to give notice of termination of the agreement and the agreement shall be terminated at midnight of the 6th day after receipt of the notice.

If this Resolution is approved, the agreement will supersede SoCal Gas' existing sales agreement with SCE dated March 17,1967, authorized by Resolution G-2668 and also supersede SoCal Gas' existing agreement with SCE for service under SoCal Gas' Rate Schedule GN-5A.

SoCal Gas recognizes that other retail UEG customers may wish to enter into similar agreements. SoCal Gas also requests that the Commission's resolution approving this agreement between SoCal Gas and SCE provide for approval of similar contracts between SoCal Gas and its other retail UEG customers and require that SoCal Gas file these contracts as compliance advice letter filings. SoCal Gas has informed the staff that all UEG customers have requested contracts in the same format as the SCE contract.

If this Resolution is not approved, SoCal Gas may seek an extension of the short term deviation granted under Resolution G-2668. The extension is necessary to insure continued use of natural gas by SCE and other UEG customers.

PROTESTS

Advice Letter No. 1619 has been protested by the Public Staff Division (PSD) on the basis that the contract before the Commission does not provide the margin necessary for a long term rate. PSD states that alternately, the Commission could direct SoCal Gas to refile an amended contract that either recovers sufficient margin contribution or would extend only until such time the Commission issues an order modifying SoCal Gas' GN-5 rate in the current CAM proceeding.

The PSD recommends that the Commission reject Advice Letter Filing No. 1619 because it collects insufficient contribution to fixed costs and inappropriately segments the market spot gas, and that the Commission should direct SoCal Gas to cure the defects addressed in this protest in one of two alternate ways. As the first alternative, SoCal Gas could file a twelve month contract for service to Edison that 1) recovers at least $0.77 per MMBtu over the incremental cost of gas for P-5 service; 2) recovers a considerably higher contribution to fixed costs for higher priority service; 3) and does not segment the sale of spot gas.

As a second alternative, PSD states that SoCal Gas should be directed to file a short-term service contract that collects the $0.45 per MMBtu set out in the Commission's Resolution No. G-2668. This contract should be expressly subject to revision by the Commission's order in SoCal Gas' pending CAM proceeding.

An additional protest was received from Texaco USA (Texaco) on the grounds that it is premature to assign a special high priority classification to the gas served under this contract until a decision has been rendered in the on-going (rate design and transportation) proceedings.

SoCal Gas responded to the protest by PSD claiming that,

"the $0.77/MMBtu recommendation by PSD is wholly impractical. SoCal Gas attempted to obtain the greatest possible margin contribution from SCE in its negotiations. It obtained more than the $0.45/MMBtu target. However, what SCE is willing to pay for gas is obviously constrained by the very low cost of its option to burn oil. SoCal Gas proposed and SCE rejected a contract which would have yielded about $0.75/MMBtu at forecast volumes. Gas priced to SCE at a rate yielding a $0.77/MMBtu margin contribution would be simply unmarketable under existing circumstances."

"The PSD's Protest is also wrong in saying that the contract would give SoCal Gas the right to sell spot gas to SCE at a cost considerably below the cost of spot gas made available to SoCal Gas' general system supply. PSD has misread the contract. In fact, the Tier II rate to SCE will be $0.15/MMBtu plus the actual average cost to SoCal Gas for all spot gas and discretionary supplies competitively priced (e.g., release gas and Pan-Alberta incentive volumes). SCE will not get the benefit of "cheaper" spot gas than system average spot gas. In referencing Section 1.d of the contract ("Incremental Gas Supply Cost"), PSD has failed to note the meaning of the included term "Short Term Purchases", which is defined in Section 1.m. Putting these definitions together, it is clear that SCE's Tier II rate is based on the average cost of all spot gas purchased by SoCal Gas (plus $0.15/MMBtu). If there is any doubt, the Commission's resolution approving the contract can clarify this point. Further, SoCal Gas does not plan a spot gas bidding procedure for UEG sales separate from its general monthly spot gas bidding procedure."

SoCal Gas' response to PSD also considers the question of priorities (as protested by Texaco) by stating that the priority of service is appropriate.

"In fact, the price paid for such a priority of service is reasonable. For Tier I gas, SCE will pay the average cost of gas excluding spot gas and pipeline demand charges, plus $0.50/MMBtu. In other words, SCE will pay a price based on SoCal Gas' firm supplies, plus $0.50.

SoCal gas continues by stating "This margin from SCE (not even considering the demand charges) compares favorably with the rate paid by P-3 and P-4 customers on Schedules GN-36 and GN-46. These customers' indexed rates are at the "floor" of swing supply gas plus $0.50/MMBtu. In its Spring 1986 CAM, SoCal Gas has stated that the swing source for the forecast period is spot gas (or competitive discretionary gas). Further, the price of Tier III gas is based on the cost of <u>firm</u> supplies to SoCal Gas. As shown in an example in Appendix "A", the overall margin on sales when SCE purchases Tier I, Tier II and 30 days of Tier III gas is in the neighborhood of $0.67/MMBtu above spot. SoCal Gas believes that the SCE contract priority treatment is harmonious with the discussion of priority of service in D.86-03-057."

SoCal Gas concludes its response by stating,

"As shown above, (in their response) the contract filed by SoCal Gas yields a margin contribution above the Commission's target, charges an appropriate rate for P-3 service, and does not segment the spot market purchasing program. On the other hand, PSD's first alternative will mean no contract at all."

"Continued short-term service is highly undesirable when the satisfactory margin contribution offered by the one-year contract can be locked in. The Commission should not have to continue to deal with this issue on a stop-gap basis when a better alternative is available."

CONCLUSIONS

In Resolution G-2668 we urged SoCal and SCE to negotiate a longer-term natural gas sales arrangement which would include a demand charge and result in a total contribution to margin of at least the $0.45/MMBtu level originally urged by staff. SoCal Gas and SCE should be commended for their efforts in developing a longer-term gas sales agreement in keeping with the Commission's previously stated guidelines.

The contract before us appears to provide slightly more than the $0.45/MMBtu that was referenced in Resolution G-2668. The PSD protest, and the responses of SoCal and Edison, focus on the adequacy of the expected margin contribution from this contract. The major points of dispute between SoCal and the PSD are the correct Tier I margin and the appropriate sales forecast for Edison. The PSD uses the stated $0.50 per MMBtu as the Tier I margin; SoCal uses the expected difference between the Tier I rate and spot gas, which is about $1.00 per MMBtu. The PSD is clearly correct on this issue. Edison has obligated itself to purchase Tier I gas; therefore under our new policy of linking firmness of supply with firmness of sales, it seems appropriate for SoCal to use long-term firm supplies to serve the Tier I load. Therefore the correct margin on Tier I sales is the $0.50 per MMBtu above the weighted average of long-term supplies. For the sales forecast, the PSD uses 600 MMcfd, SoCal 505 MMcfd. The PSD is in error here, because its 600 MMcfd includes all SoCal UEG sales, i.e. LADWP and various munis as well as Edison. The PSD forecast for Edison alone is actually 432 MMcfd, lower than SoCal's. The correct forecast will be litigated in the current Edison ECAC; using the average of the two — 468.5 MMcfd— results in a margin calculation for the contract of $87.64 million for the forecast year ($7.3 million monthly), or $0.488 per MMBtu. In addition, the contract requires SCE to pay a monthly demand charge consistent with the intent of Resolution G-2668.

In our opinion the basic structure of the SoCal-Edison contract is responsive to the new regulatory strategy we outlined in D.86-03-057. The contract contains a demand charge that is not avoidable, a first tier based on firm gas requirements that is priced in reference to long-term firm supplies, and a second tier for discretionary purchases that is market-priced. The issues which remain unresolved focus on the specific parameters of the contract. The protests submitted by PSD and other parties convince us that the issue of the appropriate <u>long-term</u> margin contribution from UEG customers should be fully examined <u>in SoCal's</u> CAM. While the $0.45/MMBtu target is appropriate as a stop-gap measure, further analysis and evidence is necessary for us to determine the appropriate long-term UEG margin contribution. The utilities are directed to make an affirmative showing in the pending CAM proceeding, A.86-03-058, to address the following issues in addition to the overall issue of the proper UEG long-term margin contribution:

1) What portion of the UEG load should be considered "firm"? The "firm" Tier I in the proposed contract is quite small, about 10% of forecasted sales, and apparently reflects Edison's average demand for P3 start-up, ignitor, and gas turbine fuel. However, Edison's episode day gas use perhaps could also be considered "firm," as well as its "baseload" gas demand that is not expected to vary with weather or hydrologic conditions. The outcome of this issue will determine how much spot gas will be targeted to serve the UEG class.

2) Closely related to the first issue is the extent to which UEG customers should contribute to pipeline demand charges. It appears that the PSD's preliminary calculation of a $0.45 per MMBtu distribution margin for the UEG class did not include a contribution to pipeline demand charges. Because UEG customers do not have a competitive option for at least a portion of their gas load, we believe that they should bear cost responsibility for some portion of pipeline demand charges.

3) Another question is the extent to which the distribution margin embedded in the UEG rates reflects the costs of serving UEG customers. The PSD claims that its work is explicitly based on a marginal cost-of-service calculation; SoCal has not explained the relationship between its negotiated margin and an embedded or marginal cost allocation.

4) Several of the protestants of AL 1619 have raised the issue of whether it is justifiable for Edison to have the highest P3 priority for Tier I and III purchases, and whether Edison is paying an appropriate premium for that reliability.

5) The margin on Tier II sales may determine how much price pressure the UEG customers' alternate fuel, residual oil, will put on gas prices. The higher this margin, the more pressure on gas prices. On the other hand, a lower Tier II margin would give the electric utilities a lower incremental gas cost, improving their bargaining positions for economy power purchases. The Commission needs to better understand this tradeoff.

In approving the SoCal-SCE negotiated contact on a short-term basis today, we do not intend to prejudge our ultimate resolution of these or other issues raised in SoCal's CAM. In fact, we expect parties to present evidence in the CAM regarding these issues.

FINDINGS

1) SoCal Gas and SCE have negotiated a contract which may be used for the retail sale of natural gas or utility electric generation on a long term (one year) basis.

2) The contract will provide a margin contribution of at least $0.45/MMBtu.

3) The issues raised by the contract, as described above, are properly matters to be adressed by the parties to SoCal's ongoing CAM proceeding, A.86-03-058.

4) The contract as presently written is reasonable and provides adequate margin contribution on a short-term basis pending further analysis in SoCal Gas CAM proceeding, A.86-03-058.

5) Further evidence is necessary to determine the appropriate long-run margin contribution from UEG customers and to address other issues as discussed above.

THEREFORE:

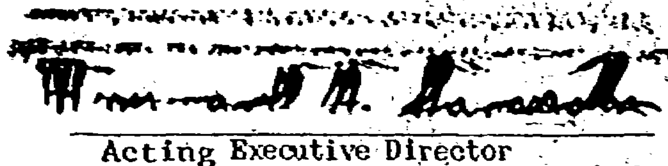
1) Advice Letter No. 1619 is approved on a short-term basis pending further analysis in SoCal Gas's CAM proceeding, A.86-03-058. The issues raised by protestants to Advice Letter No. 1619 should be fully explored in that proceeding.

2) SoCal Gas and SCE shall make an affirmative showing in the pending CAM proceeding (A.86-03-058) to fully address the issues listed above.

3) This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission May 7, 1986. The following Commissioners approved it:

DONALD VIAL
President
VICTOR CALVO
FREDERIC R. DUDA
PRISCILLA C. GREW



Acting Executive Director

Commissioner PRISCILLA C. GREW concurred in part and dissented in part.
Commissioner STANLEY W. HULETT present but not participating in voting.

PRISCILLA C. GREW, Commissioner, Concurring in part and Dissenting in part:

I concur in the list of five issues to be addressed in SoCal's spring CAM proceeding. Because of the importance of these unresolved issues surrounding the contract, however, I supported the recommendation of our Evaluation and Compliance Division, namely to refer the contract for review in the CAM proceeding rather than to approve it today. In the meantime I would have extended Resolution G-2666 to allow continuing service from SoCal Gas to UEG customers.

SoCal and SCE developed the basic structure of the contract in keeping with our previously stated guidelines. However, the majority's vote today gives an official stamp of approval to the particular values of demand charges and margin contributions chosen for this contract. I am concerned that this ratification may hinder full consideration in the CAM of alternative choices for these factors which might well be more reasonable.

PRISCILLA C. GREW, Commissioner