PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2704
November 14, 1986

RESOLUTION

PACIFIC GAS AND ELECTRIC COMPANY (PG&E) ORDER AUTHORIZING APPROVAL OF A CONTRACT BETWEEN PG&E AND SOUTHERN CALIFORNIA EDISON COMPANY (EDISON) FOR THE SALE OF NATURAL GAS FOR USE IN ELECTRIC GENERATION.

By Advice Letter 1383-G, Filed October 27, 1986, PG&E requests Commission approval of a contract between PG&E and Edison allowing PG&E on a monthly basis to sell natural gas to Edison for use in its electric generating plants.

BACKGROUND

The rapid decline in oil prices available to Edison has made it economic to use some alternative fuels. PG&E states that it is in the best interest of all of PG&E's ratepayers for PG&E to sell natural gas to Edison at a rate that will provide a contribution to the fixed costs of PG&E's gas system. The proposed contract is expected to accomplish this goal.

POSITION OF PARTIES

PG&E will be selling gas made available to its pipeline subsidiary Pacific Gas Transmission Company (PGT) under the provisions of Paragraph 4 of Schedule B of the April 1, 1986 amending agreement to the gas sales contract between Alberta and Southern California Gas Company (SoCal) for Southern California Edison's account as an addition to the existing spot purchases under SoCal's bidding program. An equivalent quantity of gas will in turn be delivered to Edison on an exchange basis.

The price charged to Edison will be the lower of : 1) 16.4 cents per therm, or 2) the Tier II price applicable under SoCal's Schedule GN-5 minus 2.0 cents per therm. PG&E will be earning a contribution to margin of 2.428 cents per therm, plus 4.4 percent for fuel and line losses.

PG&E proposes that this agreement shall continue in full force until January 1, 1987, and month to month thereafter unless terminated by either party with fifteen days prior written notice.

In addition, Edison may terminate the agreement upon fifteen days written notice if SoCal's short-term transportation rate (GST-1) is increased above 1.5 cents per therm or if Edison ceases its GN-5 Tier II purchases from SoCal. Sales under this agreement are subject to interruption if supply or capacity requirements of PG&E's other customers limit supply or system availability to Edison.

To the extent that PG&E can offer gas at a price lower than Edison's alternative fuel sources, this agreement will benefit Edison's ratepayers. PG&E will benefit by earning a contribution to margin from an entirely new market.

PG&E states that unless there is prompt action on this advice filing, PG&E and Edison will have to forego the benefits associated with this sale. Consequently PG&E requests under the provisions of Section 491 of the Public Utilities Code that this filing be approved on an emergency basis on less than statutory notice.

PROTEST BY PUBLIC STAFF DIVISION

The Commission has received protests and comments in this matter. The Public Staff Division (PSD) filed a protest to Advice Letter 1383-G, (and to Advice Letter 1382-G, a related filing) on November 5, 1986.

PSD's protest of these filings is based on the fundamental policy established by the Commission's decisions on gas transportation, that a level playing field be established for all gas sellers to California customers. Only through such a level playing field will long-term gas-on-gas competition be maintained to the benefit of all California consumers. PSD contends that the PG&E advice letter contravenes this objective as follows:

"There is no evidence that a transportation fee will be collected by PGT for the transportation service between the Canada/U.S. border and the Oregon/California border. The only charge collected for this service will be incremental fuel use on the PGT compressors.

Such a "free service" provides a considerable advantage to Canadian producers with gas reserves dedicated to Alberta and Southern (PG&E's Canadian purchasing affiliate) since such producers will receive a higher netback on their spot gas bids and hence can afford to bid lower than domestic spot gas suppliers or Canadian producers with gas reserves that are not dedicated to A&S and who would have to pay PGT a transportation fee under the new Section 7C transportation policy announced by PGT.

In short A&S producers are gaining an advantage not held by other gas producers. While PG&E emphasizes the margin contribution of 2.428 cents/therm for the intrastate transportation, it neglects to mention this indirect subsidy paid by PG&E ratepayers which results in free transportation to the border (a fully allocated rate for this transportation service has been informally estimated by PG&E at approximately 1.3 cents/therm)."

The PSD also commented that the arrangements proposed by PG&E demonstrate PSD's concerns that allowing the utilities to segment the purchasing market by entering into special sales contracts with customers will likely lead to higher gas prices for the core customers. For in this advice letter PG&E proposes to sell Canadian supplies at a price considerably lower than its existing Canadian gas costs. Hence there is no assurance that core customers will share the benefits of lower gas prices from the Canadian producers who are obviously interested in increasing their sales to California.

RECOMMENDATIONS BY PSD:

PSD proposes that the contract not be approved and PG&E be advised that the following terms and conditions be included in any agreement between PG&E and other California utilities.

1. That in the marketing of Canadian gas by PG&E, PGT should receive a fair transportation fee equal to that charged other similarly situated customers who may shortly be transporting gas under Section 7C arrangements.

2. That no marketing of spot gas should be undertaken by PG&E that will undermine the very basis of the spot market which is secret bidding by independent suppliers based on their best judgment as to the market. This means that PG&E should not be favored in spot bids by virtue of its status as a distribution company. Specifically PG&E should have to provide bids to SoCal/San Diego/SCE and similarly situated customers at least three days before receiving bids for PG&E's own spot market.

3. That no 'after the fact sales' should be allowed to occur that jeopardize the continued viability of the spot market itself, by using this spot market as merely a vehicle for price setting such as the proposed arrangement between PG&E and Southern California Edison Company (SCE) under Advice Letter 1383-G.

Finally, the PSD also believes that this advice letter is premature as the final decision and implementation of OIR 86-06-006 may soon clarify for all California utilities the terms and conditions under which they can market gas outside of their service territories.

PROTEST BY EL PASO NATURAL GAS COMPANY

El Paso Natural Gas Company (El Paso) stated in its protest that it is concerned about the ever-expanding use by PGandE of the special advantages of its affiliate, PGT, in marketing gas through non-traditional means.

El Paso states that it is not afraid of competition in the gas market so long as the rules are fair and apply equally to all. However, El Paso claims that PGandE's affiliate has a very special advantage whereby it can market Canadian gas on better terms than can domestic producers.

This advantage comes through PGT being a full cost-of-service pipeline, an arrangement which guarantees all fixed costs are fully recovered in demand charges paid ultimately by PGandE's ratepayers. Volumes transported and sold over PGT under arrangements such as are contemplated in Advice Letter 1382-G are essentially charged only incremental fuel and variable costs for shipment to the California border. PGT (and PGandE) gains no contribution to margin from this shipment.

El Paso further states that while PGandE intends to charge a fully-allocated transport cost of moving the gas from the Oregon border to SoCal, the total transport cost fom Canada with the discount on PGT markedly improves the competitiveness of Canadian gas, and in effect, the PGandE ratepayer would be subsidizing sales of Canadian gas outside the PGandE system.

This growing exercise of a rate-structure advantage is unfair, both to domestic suppliers who must compete with subsidized Canadian gas and to PGandE's ratepayers who bear the cost of that subsidy.

Second, El Paso is concerned, and believes the Commission should be concerned, that PGandE is placing itself in a position of selling Canadian gas to others at rates below those it pays for the same gas it buys for its own account.

In the new filing, (Advice Letter 1383-G) PG&E has agreed to sell gas at 5 cents per mmBtu below SoCal's spot WACOG up to a ceiling of $1.64 per mmBtu. This formula virtually guarantees PG&E will be buying gas from PGT at prices far below those PG&E pays for spot Canadian gas. One must question why this is in the interests of the PG&E ratepayer.

Further, the pricing formula will continually provide gas to a SoCal Gas csutomer below the price SoCal can obtain spot gas for its other ratepayers. Combined, Advice Letters 1383-G, 1382-G, and 1372-G (the San Diego sale) create a system whereby PG&E can sell the same gas at different prices at different places into the SoCal system as well as in its own system. This situation could lead to unintended consequences on several sets of ratepayers.

The price formula may also have adverse consequences for the overall spot gas bidding system. Facing a guaranteed discount on their prices, other spot bidders who wish to serve SoCal Gas and SCE may be reluctant to give SoCal their best bid, fearing a low SoCal WACOG could preclude a competitive bid to SCE. As a result, SoCal Gas may find its cost of spot gas is increased. Alternatively, the guaranteed discount may be self-defeating. If many bidders follow PG&E's lead and switch to a formula which sets a price below a marker, then the marker may disappear and the formula will become meaningless.

In a previous protest of PGandE Advice Letter 1373-G, El Paso recommended that the Commission establish explicit guidelines for the activities of utility affiliates in brokering gas both within and outside the service territory of the parent utility. In Resolution G-2692, on August 20, the Commission placed some restrictions on PGandE's use of its pipeline affiliate and admonished PGandE to seek open access status for PGT. However, PGandE has increased its efforts to exploit its rate structure advantages through PGT since the Commission last confronted this issue.

In this protest, El Paso renews its recommendation and asks the Commission not to approve this advice filing on an emergency basis, but instead to pause to adopt guidelines to apply to the brokering activities of PGandE on behalf of its affiliates regarding PGT and Alberta and Southern, Ltd. El Paso believes the Commission should take this pause in the interests of the PGandE ratepayer who is paying the subsidy and in the interests of ensuring fair competition.

PROTEST AND COMMENTS by TURN

Toward Utility Rate Normalization, (TURN) stated in its "limited" protest that it has no desire to prevent inexpensive supplies of Canadian gas from competing in the California market -- indeed, ratepayers across the state should benefit from this additional source of low-cost gas. For this reason TURN does not object to the Commission's granting interim approval of the PG&E proposals.

But it cautioned that such interim approval should be followed by prompt Commission hearings to examine the terms and conditions of the proposed arrangements.

TURN then reiterates the concerns expressed by El Paso in its protest and summed up by stating:

"These matters should be reviewed by the Commission at the earliest possible date in evidentiary hearings. In the meantime, TURN does not object to the proposed transactions going forward, so long as there is a prompt opportunity to examine the structure of the proposed deals."

RESPONSE TO PROTESTS:

PGandE responded to the protest of El Paso on November 4, and to PSD on November 6, 1986 as follows:

El Paso's reasons for protesting this contract stem from the claim that PG&E ratepayers are somehow "subsidizing" sales of Canadian gas outside the PG&E system.

PG&E states that this claim is totally false. PGT's fixed costs are paid by all of PG&E's ratepayers regardless of whether sales are made to this totally new market. PG&E ratepayers will not bear any additional costs as a result of gas flowing under this contract. In fact, if PG&E is able to sell 100 million cubic feet of gas a day to SoCal Gas between now and the end of the year, PG&E will earn a contribution to margin of over $1,000,000. This contribution will offset all of PG&E's fixed costs (including the PGT cost of service).

El Paso's suggestion to the Commission to pause to adopt guidelines for the activities of utility affiliates is nothing more than a ploy to delay the approval of a contract that will make available a new low cost source of gas to California, in effect reducing the competition El Paso claims it is unafraid of. The contract before the Commission is short-term in nature, and any additional delay would simply prevent PG&E ratepayers from benefiting from the substantial contribution to margin during the immediate future.

An additional argument advanced by El Paso and the PSD is that adoption of these contracts will have adverse consequences for the overall spot gas bidding system. This argument ignores the realities of today's highly competitive spot gas market. There is no barrier to preclude other spot bidders (including El Paso) from signing similar contracts to those proposed in Advice Letters Nos. 1382-G and 1383-G. In fact, the only difference is that other spot bidders may do so without obtaining CPUC approval.

Finally, PG&E concludes that the interests of El Paso and others who wish to push foer higher gas prices may be aided by delay, but the interests of California consumers, both in Northern and Southern California, will be hurt if the Commission does not allow this agreement to be put into effect without delay.

DISCUSSION

The PSD and El Paso have legitimate concerns about this proposed contract as it relates to the spot market functions and the subject of natural gas transportation. However, until some of these questions are more firmly resolved in the several ongoing

Commission proceedings, we believe it is in the best interest of the majority of ratepayers to approve this contract on a short-term basis as noted below. The proposed month by month continuation feature should permit the parties to terminate or to modify the contract if the Commission finds that the public interest so requires.

PG&E's contract with Edison raises several issues, some of which can be resolved in this resolution, others of which may not be resolved until our gas industry OIR is implemented. The contract as proposed is deficient in that it fails to collect anything but a deminimis fee for PGT's interstate transportation and may undermine SoCal's monthly spot bidding program. However, if modified as this resolution suggests, the contract should benefit both PG&E and Edison ratepayers.

A primary issue is raised by the fact that the gas under contract would be transported from the Canadian/U.S. border to the Oregon/California border by PGT. PGT is a wholly-owned pipeline subsidiary of PG&E. PG&E's ratepayers pay for PGT's facilities and services through a full cost of service tariff. PGT's cost of service is forecast annually and the forecast is incorporated in PG&E's revenue requirements.

We agree with the protestants that PG&E's ratepayers should be fully compensated for the transportation of gas under this contract from Canada to the Oregon/California border. Failure to collect a fully allocated transportation rate would result in higher net back to A&S's producers than would be realized by other Canadian producers or domestic producers. PG&E ratepayers do not benefit from such an arrangement. Other producers would be disadvantaged by this. We desire to maintain California's attractiveness as a market for natural gas sales and believe that a contract which unduly favors one group of producers over others would discourage would-be sellers from marketing gas to California. We also expect that a public utility would maximize revenues from facilities paid for by ratepayers. Thus, PG&E's argument against the collection of fees for PGT's interstate transportation, which is based on the fact that PGT presently does not contribute transportation revenues to its cost of service, lacks merit.

We require that PGT collect transportation fees for gas sold under this contract and credit them to a memorandum account. The fees should be equal to the fully allocated transportation rate PGT charges its unaffiliated transportation customers under Section 7(c) contracts, as that rate would exist for transportation from the Canadian to the California end points of the PGT system.

We share the protestant's concerns that pricing the gas sold under this contract at 0.5 cents/therm below SoCal's weighted average

cost of spot gas will disrupt SoCal's spot bidding mechanism. The spot gas program has proven valuable to all the states gas ratepayers and must be preserved. Secondly, PG&E should not be able to utilize information available to it as a recipient of monthly spot bids to its competitive advantage in making spot bids. In the long run, that advantage could reduce competition and result in higher prices to core customers.

We reject the contract as written because of its indexing provision. PG&E may make sales under a blind-bidding procedure, provided it submits its bid to SoCal in advance of its receipt of bids. Under such an alternative, the integrity of SoCal's spot gas bid program should be protected.

The protestants also question whether the off-system sales of gas at prices that appear to be below PG&E's own weighted average cost of spot gas are in the best interest of PG&E's ratepayers. Our requirement that PGT collect a fully allocated transportation rate will result in savings to PG&E's ratepayers. Ultimately we rely on our traditional reasonableness reviews of PG&E's gas purchases to encourage PG&E to act in the best interest of its ratepayers.

Though our conditional approval of PG&E's advice letter may result in off-system sales at prices below PG&E's own Weighted Average Cost of Gas (WACOG) today, PG&E will be bound by our final determination on this issue in OIR 86-06-006. The issue of off-system sales below the selling utility's WACOG may well be resolved differently in our final OIR decision, but we do not fear that today's approval will prejudge our future actions because the contract, as proposed, is effective through December 31, 1986 and on a month-to-month basis, only after that.

Likewise, we raised the issue in the OIR whether or not a utility or its affiliate should be allowed to act as gas brokers. A rule was proposed for comment. Since the matter is still under submission and the contract, as approved, would terminate in December subject to monthly renewals, an approval of PG&E's role in marketing Canadian gas to Southern California cannot be interpreted as precedent setting.

By approving the contract subject to these conditions, we alert gas producers to our commitment to provide a level playing field for gas to gas competition. It is important that all producers have fair and equal access to the California market. We emphasize the need of Canadian producers, especially those not associated with A&S, to have access to the California market. PG&E has advised the Commission that its filing for Section 436 open access

transportation authority is imminent. We anticipate that when open access is provided over the PGT line, greater competition from Canadian producers will result in lowered gas prices to the state's gas ratepayers.

PUBLIC NOTICE

Public notification of this filing has been made by mailing copies of the advice letter to other utilities, governmental agencies, and to all interested parties who requested them, including the parties of Record in I.86-06-05 and R.86-06-006.

FINDINGS

1. The contract as proposed by PG&E would benefit Edison's ratepayers with low cost gas from Canadian producers associated with PGT.

2. The contract as proposed by PG&E would grant Canadian producers associated with PGT an advantage over other gas producers because their net back would be exclusive of any fees for transportation from the Canadian/U.S. border to the Oregon/California border.

3. PG&E's ratepayers, who support the PGT pipeline by paying its cost of service in rates, should receive revenues equal to PGT's fully allocated cost of service for PGT's interstate transportation of gas pursuant to the contract.

4. The contract as proposed will undermine SoCal's spot bidding program because bona fide spot bids would consistently be underbid by PG&E, and PG&E would be able to use information received as a spot gas purchaser to undercut bids by spot gas sellers.

5. PG&E's advantage over other spot bidders should be eliminated by requiring PG&E to place its bid with Edison in advance of its receipt of bids under its own spot bid program. PG&E should not discount its bid or otherwise guarantee its rate.

6. The role of a utility as a gas broker and the desireability of off-system sales at a price below the utility's weighted average cost of gas are issues before us in the gas OIR. Since these matters have not been resolved from a policy standpoint, our approval of the contract, if modified, should not be taken as precedent for approval of other off-system sales.

7. Since the subject contract expires December 31, 1986, and may be renewed on a month-to-month basis thereafter, the parties should have no difficulty in modifying the contract to conform

with our orders in OIR 86-06-006 and OII 86-06-005 when they are issued.

8. Approval of this contract should not continue in effect if the contract is inconsistent with the results of OIR 86-06-006 and OII 86-06-005 after December 31, 1986.

THEREFORE:

1. Under the provisions of Public Utilities Code 454 and 491, Pacific Gas and Electric Company is authorized to enter into a contract with Southern California Edison Company, for the sale and transport of natural gas; subject to the terms set forth in the advice letter and the accompanying contract and further subject to the conditions stated in this Resolution.

2. Gas sold under this contract shall be charged the fully allocated cost of transportation charged by PGT under Section 7(c) for interstate transportation provided from the U.S./Canadian border to the Oregon/California border. The transportation revenues for the remainder of 1986 shall be recorded in a memorandum account flowed through to PG&E ratepayers in the next gas adjustment clause proceeding. The balance of the memorandum account shall be reported to the Commission's Evaluation and Compliance Division's Energy Branch, Tariff Unit, by January 15, 1987.

3. We require a blind-bidding procedure, whereby PG&E shall submit its bid to Edison in advance of its receipt of bids from spot sellers for its own purchases. PG&E shall conduct its bidding program to coincide with the date and time of SoCal Gas's spot bidding program.

4. Pacific Gas and Electric Company will be required to furnish data to establish the volumes and prices used for this contract. PG&E is hereby directed to furnish the contribution to margin from this contract quarterly, beginning 30-days after the first three months of operation, to the Evaluation and Compliance Division's Energy Branch, Tariff Unit, of this Commission.

5. The authorization granted herein will be subject to any change or modification resulting from the Commission adopting its Final Order in OIR 86-06-006.

6. The above advice letter and contract form shall be marked to show that they were authorized for filing by Commission Resolution G-2704, to be effective on and after November 14, 1986.

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

8. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission on November 14, 1986. The following Commissioners approved it:

Executive Director

DONALD VIAL
President
VICTOR CALVO
FREDERICK R. DUDA
STANLEY W. HULETT
Commissioners