

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

EVALUATION & COMPLIANCE DIVISION
Energy BranchRESOLUTION G-2747
September 23, 1987.R E S O L U T I O N

RESOLUTION G-2747, SOUTHERN CALIFORNIA GAS COMPANY (SOCAL) REQUEST FOR AUTHORIZATION OF A GAS TRANSMISSION SERVICE CONTRACT WITH ENERGY RESERVE INC. FOR ENHANCED OIL RECOVERY (EOR) USE. BY ADVICE LETTER 1722, FILED AUGUST 17, 1987.

By Advice Letter No. 1722, Filed August 17, 1987, Southern California Gas Company (SoCal) submitted for approval a Gas Transmission Service Contract between Energy Reserve Inc. (Energy) and SoCal, in accordance with the general findings and conditions of Decision No. 86-12-009 (pg. 69), dated December 3, 1986 and Rate Schedule GLT.

BACKGROUND

1. SoCal Rate Schedule GLT is applicable to long-term transportation of customer-owned natural gas for use in Enhanced Oil Recovery (EOR) facilities as provided by Decision 86-12-009, including gas used for combined EOR/cogeneration facilities and under the terms of a negotiated Gas Transmission Service Contract. Transportation service under this schedule is limited to volumes equal to or in excess of 250,000 therms per year to each customer's premises as defined in SoCal's Rule No. 1, Definitions.
2. The rate schedule provides that the Utility and customer shall negotiate a transmission rate, a Customer Charge and an appropriate escalation factor to be stated in the Gas Transmission Service Contract. A separate priority charge may be negotiated, a Demand Charge component also may be included. The negotiated transmission rate shall be set neither below the floor rate (short-term marginal cost) nor above the ceiling rate (long-term marginal cost).
3. The rate also will include any applicable taxes, fees, regulatory surcharges, intra-or-interstate pipeline charges

imposed as a result of transporting gas under the schedule. In the event customer delivers more or less gas into the Utility system than it accepts on redelivery, such imbalances shall be specifically provided for in the contract.

4. To renew the terms of service under the Service Contract, notice from the customer is required at least fifteen days prior to the expiration of the existing contract, and renewal is subject to available capacity on the Utility system as determined by the Utility. At the end of the initial term, the original rate will be revised to an appropriate negotiated rate at the time of renewal.

5. Customers may receive service under the GLT schedule (a) separately or (b) in combination with an applicable sales rate schedule. Where service is rendered under (b), a separate monthly customer charge shall be applicable for service under each schedule. If service is rendered under (a), the customer must still meet the terms and conditions of the customer's otherwise applicable sales rate schedule.

6. Energy Reserve, Inc. is a company engaged in Enhanced Oil Recovery (EOR) in the San Joaquin Valley. The volumes to be transported initially will be 18,000 therms per day, and are forecasted to reach 170,000 therms per day by mid-1991.

SUMMARY OF CONTRACT TERMS

1. The Energy Reserve Inc. contract is for gas transportation. It provides for a transportation charge and a monthly customer charge. In addition, there is a provision for rate escalation and an option to negotiate a priority charge. The term of the agreement is twenty three years. A separate sales agreement will be signed after Commission approval of the transmission contract.

2. This is the second EOR contract submitted by SoCal Gas for approval under the terms of the GLT schedule, as provided by Decision 86-12-009.

3. The contract contains the following rates and charges:

- (1) Customer Charge: The customer shall pay a monthly customer charge of five hundred dollars (\$500.00) per each premise.
- (2) Transmission Charge: In addition, the customer shall pay a transmission charge of three and six hundred seventy-five thousandths cents (3.675¢) for each therm of gas accepted at the points of delivery. If the

customer's gas usage is both EOR and non-EOR usage, the customer will specify the percentage of each in Exhibit A herein. Only gas used for EOR operations will be billed at this charge.

- (3) Escalation: The transmission charge under this agreement shall be adjusted upward or downward on January 1, 1988 and on each January 1 thereafter by an escalation factor equal to changes in SoCal's total Authorized Margin as it is determined in the most recent General Rate Case or Attrition Allowance according to the following formula:

$$\text{New Rate} = \text{Current Rate} \times \frac{\text{New Authorized Margin}}{\text{Base Authorized Margin}}$$

The Base Authorized Margin is the Authorized Margin as of the scheduled date of first deliveries. Such transmission charge shall be adjusted every January 1 either upward or downward by no more or less than seven percent (7%) of the Current Rate provided, however, that if such escalated rate at any time results in a rate less than the minimum rate acceptable to the California Public Utilities Commission (CPUC) plus one half cent (.5¢) per therm ("Minimum Rate"), SoCal has the right to make such Minimum Rate effective as the Transmission Charge herein.

- (4) Priority Charge: The customer shall not pay an additional charge to establish its priority of service under SoCal Tariff Rule 23 at this time. In the event priority charges are negotiated with other EOR customers, either party may initiate negotiations for a priority charge to be added hereunder.

4. The contract is proposed to become effective as of six o'clock (6:00) a.m. local time on the Scheduled Date of First Deliveries as set forth in Schedule A, and shall continue in full force and effect for twenty-three (23) Years (the "Initial Term").

5. If at any time the method of calculating SoCal's margin is modified by the CPUC, SoCal and Energy shall agree upon a new price reference or formula to calculate future rates.

6. The initial volumes agreed to be transported shall be 18,000 therms per day for EOR steamflood use. Beginning in June 1989, up to 80,000 therms per day will be transported for EOR related

cogeneration activities. Beginning in June 1991, the cogeneration usage forecast is 170,000 therms per day.

7. SoCal requests that this filing be made effective for service on and after September 23, 1987. SoCal seeks expeditious approval since Energy Reserve Inc. requires Commission approval so that they may secure the necessary additional financing to purchase and install cogeneration equipment.

DISCUSSION

1. A number of Commission concerns were aired in a meeting between Commission staff and SoCal on August 28, 1987. The following issues were clarified:

A. Fuel and Line Losses - SoCal has negotiated with the understanding that the fuel and line losses are a part of the transportation charge. This is in lieu of the more standard, in-kind reimbursements found in the interstate market.

B. Priority Charge - Section 1.4 of the contract refers to EOR and EOR associated cogeneration, and not just to EOR production. Any priority charge under the contract, without a modification to the contract, would be added to the transportation rate.

C. Take-or-Pay Provisions - The contract binds the customer to the take-or-pay provision on the increased volumes under Attachment A of the contract, whether or not the customer has the ability to burn the quantities stipulated in the contract.

D. Applicable Schedules - SoCal had not considered the impacts upon the sales rate and/or priority of the contract language which provides for the G-COG/GN-7 Schedules as the applicable sales rate. The issue arises because the G-COG and GN-7 tariffs will likely be abolished by the Commission in the implementation decision in OII-86-06-005 et. al. SoCal states when the sales agreement is signed, language will be included to transfer the customer to the applicable sales schedule(s) adopted by the Commission in the implementation decision.

E. Duration of Contract - SoCal stated that the twenty three year contract length was requested by Energy. The length is required due to a similar contract with Pacific Gas and Electric for electricity, and by Energy Reserve,

Inc.'s bank for assurances against risk for such an investment.

2. Article 3, Deliveries, Section 3.1 includes the following sentence, "SoCalGas will first credit Quantities of Gas remaining in Customer's Month to Month balancing account provided for below, then Customer shall purchase any additional Gas directly from SoCalGas under the current applicable sales rate schedule for which Customer then qualifies as set forth in Exhibit A. Customer has the right to purchase Gas at any time under the terms and conditions of its applicable sales rate schedule." Since the applicable rate schedules under which customers may be served by this contract are Schedules GN-7 and G-COG, and since these schedules may expire due to the implementation of decisions in OII 86-06-005 and/or OIR 86-06-006, the staff believes that at the expiration of GN-7 and G-COG, customers under this contract will thereafter be served under whatever schedule that the customer's characteristics would otherwise entitle it to.

3. The Commission has stated in several of its recent decisions that the most efficient and economical means of serving the Kern County EOR market is to serve that market through the systems of California's two major state-regulated local distributing companies. No interstate pipeline is needed to meet the reasonable service needs of California gas consumers, including Kern County operators, at just and reasonable rates."

4. SoCal has stated "the CPUC has put in place a regulatory framework that enables the utilities to serve EOR producers at a price that cannot be matched by the interstate pipeline applicants; that the CPUC has ordered the utilities to serve the EOR market competitively and to negotiate transmission rates down to a floor of 1¢ per therm; that the utilities are authorized to negotiate long-term contracts of up to 20 years; and that the CPUC intends to respect the sanctity of contracts negotiated between the utilities and EOR producers."

5. The EOR market is attractive because it represents incremental load at a time when the gas utilities have excess capacity to serve this load. As long as the rates negotiated with EOR customers exceed the marginal cost of service, all ratepayers will benefit from the additional contribution to cover the utilities' fixed cost. The adage that "some margin is better than none" explains why the floor was set at a rate equal to short-run marginal cost in D.86-12-009. It also explains the Commission's opposition before FERC regarding the certification of a new interstate pipeline to serve the EOR market. Serving the incremental EOR market with the utilities' existing facilities can be positive for ratepayers because there is no subsidy flowing to the EOR market, as long as rates exceed the marginal cost of service.

6. In D.86-12-009, the Commission required the utilities to file all long-term contracts (contracts with terms of five years or more) with the Commission for approval by advice letter. This procedure was instituted to protect ratepayers from some of the risks inherent in long-term contracts that offer pricing certainty. It also affords the Commission with the opportunity to assure that all long-term contracts are consistent with the guidelines established in D.86-12-009 and D.86-12-010. The Commission has reviewed the SoCal/Energy contract to see that it meets the general guidelines established in D.86-12-009. But, this review should not insulate utilities from their responsibility to negotiate reasonable long-term contracts in the interest of all utility ratepayers. The Commission has stated in D.86-12-009 that the utilities bear some of the risks of long-term contracts and are responsible for negotiating contracts that are consistent with market realities (D.86-112-009 at mimeo pp. 41-42).

7. The Commission believes that on balance, the SoCal/Energy contract is reasonable in light of current market conditions and the importance of serving the EOR market.

8. Although the negotiated 3.675 cent/therm rate is below embedded cost, the Commission believes that this rate bears a reasonable relationship to current market conditions and will provide ratepayers with significant margin contribution over the life of the contract. The negotiated rate is clearly above the 1 cent/therm floor established in D.86-12-009. It is higher than the 3.5 cent rate in the SoCal/Texaco EOR gas transportation contract which was approved in D.85-12-102.

9. The Evaluation and Compliance Division has no objections with this advice letter filing and recommends approval of this contract with Energy Reserve Inc.

10. SoCal has requested that this filing be made effective for service by September 23, 1987.

11. 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 OII 86-05-005 and OIR 86-06-006.

12. No protests to this advice letter have been received.

FINDINGS

1. The enhanced oil recovery market currently represents the largest new market for natural gas in California.
2. It is reasonable for SoCal to provide service to Energy under the terms and conditions of this contract to maintain sales at competitive natural gas prices, in accordance with Decision 86-12-009, therefore:

IT IS ORDERED THAT:

1. Under the provisions of Public Utilities Code Sections 454 and 532, Southern California Gas Company is authorized to enter into a contract with Energy Reserve, Inc. for the sale or transport of natural gas subject to the terms set forth in the advice letter and the contract submitted with the advice letter.
2. Southern California Gas Company will be required to furnish data to establish the volumes and prices used for this contract, and the contribution to margin from this contract annually or at the time of each revision in the transportation rate, beginning 60-days after the first such revision in rates, to the Evaluation and Compliance Division, Energy Branch.
3. The above advice letter and contract form shall be marked to show that they were authorized for filing by Commission Resolution G-2747, to be effective on or after September 23, 1987.
4. This Resolution shall be served on all parties to the Commission's ongoing Rate Design proceedings in OII 86-06-005 and OIR 86-06-006.
5. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission on September 23, 1987. The following Commissioners approved it:

STANLEY W. HULETT
President
DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners



Executive Director