PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2815
SEPTEMBER 14, 1988

R E S O L U T I O N

RESOLUTION G-2815, SOUTHERN CALIFORNIA GAS COMPANY REQUESTING APPROVAL OF A GAS TRANSMISSION SERVICE CONTRACT WITH TENNECO OIL COMPANY. FOR ENHANCED OIL RECOVERY USE; BY ADVICE LETTER 1806, FILED JUNE 25, 1988.

SUMMARY

1. By Advice Letter No. 1806, Southern California Gas Company (SoCal) submitted for approval a Gas Transmission Service Contract with Tenneco Oil Company (Tenneco). In accordance with Decision (D.) 86-12-009 and Rate Schedule GLT, Long Term Transportation of Customer-Owned Gas. The initial term of the contract runs for five (5) years but may be extended to twenty (20) years. Protests of the Division of Ratepayer Advocates (DRA), Southern California Utility Power Pool and Imperial Irrigation Districts (SCUPP/IID), and the Southern California Edison Company (SCE) do not provide sufficient basis to deny SoCal's advice letter. This resolution approves the contract.

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. This includes gas used for combined EOR/cogeneration facilities. Service is to be provided 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.

2. The rate schedule provides that the Utility and customer negotiate a transmission rate, a Customer Charge and an appropriate escalation factor to be stated in the contract. A separate priority charge may be negotiated, a Demand Charge component also may be included. The negotiated

transmission rate may be set neither below the floor rate (short run marginal cost) nor above the ceiling, default rate (long run marginal cost).

3. The rate also will include any applicable taxes, fees, regulatory surcharges, and intra-or-interstate pipeline charges imposed as a result of transporting gas under the schedule. The treatment of imbalances that occur when the customer delivers more or less gas into the utility system than it accepts on redelivery must be specifically provided for in the contract.

4. To renew the terms of service under the contract, notice from the customer is required at least fifteen days prior to expiration. 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.

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 is 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.

SUMMARY OF CONTRACT TERMS

1. This contract is submitted by SoCal for approval under the terms of the GLT schedule as provided by D. 86-12-009.

2. The contract contains rates and charges which are summarized below:

a. Customer Charge: The customer shall pay a Monthly Customer Charge of five hundred dollars ($500.00) per premise.

b. Transmission Charges: The customer shall pay a Transmission Charge of 3.5 cents for each therm of gas accepted at SoCal's points of delivery.

c. Escalation: The Transmission Charge under the Contract will be escalated on January 1, 1989 and on each January 1 thereafter by an escalation factor equal to changes in SoCal's total authorized margin from the prior year. In any event, the charge shall not be increased by less than 3% or more than 5% of the then current rate.

3. Service Term: The initial term of the contract is five years, and may be extended to fifteen (15) years as upon Tenneco's request. The contract may be extended by mutual agreement of the parties for additional one (1) year periods subject to the availability of capacity as determined by SoCal.

4. Minimum Transmission Obligation: There is no fixed demand charge, however, Tenneco is required to transport, and/or to purchase from SoCal not less than 50% of its annualized contract quantity. If this quantity is not transported or purchased by Tenneco, Tenneco will pay the transmission costs for this minimum quantity. Make-up is allowed in the two-year period following the underdelivery, however, the right to make-up only extends for one year after contract termination.

5. Surcharges: There is a 0.297 cent per therm surcharge for gas transported over the El Paso system unless Tenneco demonstrates to SoCal that it is exempt from the FERC settlement in Docket No. RP86-45-00. There is a state regulatory surcharge of 0.068 cents per therm.

6. Interruption of Service: Customer's priority of service shall be established under Tariff Rule 23 or any succeeding version. In the case of a capacity shortage the customer shall be curtailed on the basis of the customer's priority charge. If the priority charge is zero, curtailment will occur according to the end-use priority system.

7. Quantities: The initial contract daily quantity shall be 197,000 therms of which 81,000 shall be used for cogeneration. Tenneco has the option within the first two years of the contract to raise the daily quantity to 400,000 therms.

DISCUSSION

1. The Commission segregated EOR customers from other ratepayers in Decision 85-12-102, allowing the utilities the negotiating flexibility they required to meet the needs of their EOR customers and to meet the competition of the interstate pipeline proposals. The Commission limited the escalation rate to a range of three to five percent, but added further that the "utilities will be free to negotiate any type of appropriate escalation factors (such as an escalation index based on changes in field crude oil prices) or other rate provisions as appropriate for EOR customers."

2. D.85-12-102 set contract term minimums at 5 years, envisioning contract terms up to 20 years. No conditions were placed on the utilities to establish contract

reopeners, but instead, the utilities were urged to negotiate the best terms possible with this new, emerging market.

3. D.85-12-102 also stated that "should a negotiated rate ever become less than the floor described above (3 cents per therm at the time), shareholders will be at risk for making up the deficiency." Finding 54 (at p.46) states: "A 50% take-or-pay provision is a reasonable condition to all long-term transportation agreements in order to encourage transportation customers to transport their own gas for the entire life of their contract."

4. In a continuing effort to support the utilities in negotiating EOR contracts at substantially competitive rates so that the EOR customers would be retained on the utility systems, the Commission determined that all EOR revenues were to be treated as incremental. D. 86-12-009 established that the floor for this market was to be the variable cost of transmission, then estimated at 1¢ per therm. D.87-05-046 changed the incentive mechanism established in D.85-12-102[1] to reflect this lower floor rate and to allocate revenues above the floor rate 5% to shareholders and 95% to ratepayers.

5. The Commission requires that each long-term contract be submitted individually for review. This procedure was instituted to protect ratepayers from some of the risks inherent in long-term contracts that offer pricing certainty. It also assures that the Commission is regulating these contracts directly so that they are consistent with all effective regulations and guidelines.

6. The staff of the Commission Advisory and Compliance Division (CACD) has reviewed the terms of the contract and has determined that it is in compliance with Commission Decisions 85-12-102, 86-12-009, 87-05-046 and 87-12-039, the gas implementation decision.

7. 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.

[1] Previously, based on the 3¢ floor set in D. 85-12-102, the incentive mechanism was applied to amounts collected above 3¢ per therm, allocating 25% of any overage to shareholders and 75% to ratepayers.

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8. The Division of Ratepayer Advocates (DRA), filed a timely protest stating that: 1) the contract should have been negotiated under tariff GT-40 rather than GLT; 2) SoCal should have negotiated better terms to the benefit of ratepayers; and 3) recommending that the priority level of service should be determined in the procurement OII.

9. Negotiations leading to this contract were initiated under Tariff GLT before Schedule GT-40 was available. As of the filing date of this advice letter GLT was an applicable tariff. Furthermore, as noted by DRA the new Tariff GT-40 differs substantially from GLT only in the requirement for alternative fuel capability set forth in GT-40. However, Public Utilities Code Section 2773.5 specifically prohibits any requirement for EOR customers to maintain alternative fuel capabilities. SoCal has filed Advice Letter No. 1813 to correct this error.

10. The mechanism we have adopted to assure that the gas utilities negotiate the best possible EOR contracts is to provide the utilities with a direct financial interest in their outcome. At present, under D.87-05-046, EOR transportation revenues in excess of shortrun marginal costs, estimated at one cent per therm, are split between stockholders and ratepayers in the ratio of 5 percent and 95 percent, respectively.

11. The contract's Interruption of Service provision relies on "...Rule 23 <u>or any succeeding rule</u>" which provides adequate assurance that curtailment will reflect final decisions in the Procurement Investigation I.86-03-036.

12. Southern California Edison Company (SCE), filed a timely protest stating that EOR customers should pay a rate comparable to that charged other SoCal customer's until the competitive alternative, another interstate pipeline, is actually built. SCE also states that SoCal will lose margin contribution if EOR deliveries at 3.5 cents per therm displace UEG deliveries at 8.9 cents per therm.

13. We find no merit in SCE's suggestion that another interstate pipeline be built to serve EOR customers before EOR customers are provided with rates needed to hold them on the existing utility's system. This would be a wasteful investment that would not benefit SoCal's ratepayers.

14. There may be some curtailment on the SoCal system this Fall due to the unusual simultaneous occurrence of a severe drought and a very cold Winter which forced up gas demand to unforeseen levels. However, by our emergency order of August 24, 1988 we have taken steps to greatly reduce prospects of

gas curtailments to SoCal's UEG customers. The implementation of that order will enhance gas availability to UEC customers in the Los Angeles Basin during the period of reduced air quality. Furthermore, we ultimately expect that the order of curtailment will be based on a priority charge bidding system, which will allow noncore customers, such as SCE, to pay for whatever priority of service they desire. Finally, the choice is not between the margin contributions from EOR customers and UEG customers. As we explain in more detail below, curtailments are exceptional events that are the products of exceptional circumstances. Curtailments are rare events. The real choice is between having EOR customers contribute to the support of the existing utility system to the benefit of all ratepayers, or losing that revenue to interstate pipeline. We find SCE's concern about margin loss, both in the near and more distant future, unfounded.

15. The Southern California Utility Power Pool and the Imperial Irrigation District (SCUPP/IID) filed a timely protest indicating that curtailment events of the last two years demonstrate that SoCal now lacks the capacity to provide reliable service to existing customers let alone to new customers. SCUPP/IID asks for an immediate investigation of the current curtailment situations, and of the need for, and cost of, new capacity to serve SoCal's existing customers and new EOR customers. Finally, SCUPP/IID requests the Commission to "reexamine the now outdated EOR promotional policy that was adopted in D.85-12-102 and D.86-12-009".

16. The central question as regards this protest is whether the curtailment events of the recent past signal a capacity shortage on the SoCal system. The California Energy Commission's report "Southern California Gas Company's 1987-88 Curtailment" while urging general caution in making additional EOR commitments, as pointed out by SCUPP/IID, makes two major points. Its main point is that the curtailments of last Winter were "...primarily a shortfall of gas supply rather than a shortage of capacity to deliver gas", (page 30). As far as future capacity shortages are concerned, the CEC is not prepared to offer a definitive opinion at this time, other than to say that "As long as California and the entire U.S. gas market is in the midst of a regulatory transition, the bottom line effect on future curtailment cannot be determined", (page 42). The current difficulties appear to be the result of the improbable simultaneous occurrence of a number of extreme events: (1) a cold spell last winter of near one-in-one-hundred year magnitude, (2) two consecutive dry years and, (3) unplanned outages at several major nuclear plants. These events combined to push up the demand for gas, at a time when there

were operational problems on the interstate pipeline system. With so many potential variables affecting the balance between supply and demand, it is not possible to construct an absolutely fail-safe system. Nor would it be economical to do so. That is why we have curtailment rate options. Of course, non-core customers will have an opportunity to determine the security of their service by their priority charge bid. We expect that in the future actual curtailments, if any, will be the products of exceptional events, as are the current shortages. The Commission considers long-term gas delivery issue such as those raised by SCUPP/IID to be important.The Commission will continue to give them consideration now and in the future, but does not believe that such consideration warrants rejection of EOR contracts at this time.

FINDINGS

1. The enhanced oil recovery market currently represents the largest new market for natural gas in California. It is a benefit to all California ratepayers for this market to be served through utility service.

2. The proposed contract under which SoCal will provide service to Tenneco will maintain utility transportation of gas to the EOR market, is a benefit to all ratepayers, and is in accordance with Decisions 85-12-102, 86-12-009, 86-12-010, and 87-12-039.

IT IS ORDERED, that:

1. Southern California Gas Company is authorized, under the provisions of Public Utilities Code Section 532, to enter into the contract with Tenneco Oil Company for the transportation of natural gas as submitted by Advice Letter 1806.

2. Southern California Gas Company shall be required to furnish data to establish the volumes, price, and priority used for this contract, and the contribution to margin from this contract annually, and at the time of each revision in the transportation rate, beginning sixty (60) days after the first such revision. This information shall be sent to the Chief of the Energy Branch, Commission Advisory and Compliance Division.

3. Advice Letter 1806 and the accompaning agreement shall be marked to show that they were approved by Commission Resolution G-2815.

4. This Resolution is effective today.

I certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting of September 14, 1988. The following Commissioners approved it:

Executive Director

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