PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-2899
December 6, 1989

R E S O L U T I O N

RESOLUTION G-2899. SOUTHERN CALIFORNIA GAS COMPANY REQUESTS APPROVAL OF A FIVE-YEAR GAS TRANSMISSION SERVICE CONTRACT WITH UNION CARBIDE INDUSTRIAL GASES, INC.

BY ADVICE LETTER 1888, FILED ON JULY 26, 1989.

SUMMARY

1. By Advice Letter 1888, Southern California Gas Company (SoCal) submitted for approval a five-year negotiated contract for gas transmission service between Union Carbide Industrial Gases, Inc (Union) and SoCal.

2. This Resolution approves the contract but orders modification of the Advice Letter filing to remove certain language.

BACKGROUND

1. Union operates a plant in Wilmington, California, which manufactures industrial gases. Prior to entering negotiations with SoCal, Union was planning to operate its cogeneration facility as a dispatchable peaking unit for Los Angeles Department of Water and Power (LADPW), purchasing butane from an adjacent facility. There are several other nearby butane sources. This contract, if approved, will secure a new long-term load which is expected to result in transportation of over 19,000,000 therms per year with an average transmission rate of $0.07948 per therm.

2. Decision 87-02-029, dated February 11, 1987, defines the noncore market as comprised of all customers with end-use Priority 3 and below and states that all customers in the noncore market are eligible to select among a variety of transmission and procurement options. Union is such a noncore customer.

3. Decision 86-12-010, dated December 3, 1986, states on page 29, that "...the primary mode of service to noncore customers will be negotiated service contracts..."

4. Decision 86-12-009, dated December 3, 1986, requires an advice letter to be filed for contracts having terms of five years or greater.

5. SoCal mailed copies of this filing to other utilities, governmental agencies and interested parties who requested it.

CONTRACT PROVISIONS

1. The contract provides for a $50 monthly customer charge and a two-tier transmission rate. The tier I rate is $0.08 per therm and applies to volumes up to 50,000 therms per day. The tier II rate is $0.07 per therm applied to volumes in excess of 50,000 therms per day. The minimum delivery quantity is 40,000 therms per day (80% Tier I take-or-pay).

2. The contract rate will be applied instead of the average UEG (Utility Electric Generation) rate as provided in Rate Schedule GT-50.

3. The initial term of the contract is five years. After the initial term, the contract will be automatically extended for successive one-year periods. The contract may be canceled by either party on 12 months' written notice or by mutual agreement of both parties.

4. The contract begins on the next meter-read date following Commission approval.

5. The contract has an escalation provision whereby the rates are adjusted at contract year end based on changes in the Consumer Price Index as defined in SoCal's tariff Rule No. 1.

6. The contract provides for a minimum delivery quantity of 40,000 therms per day.

7. The Advice Letter, on page 2, paragraph 4, states:

> "By approving this advice filing, the Commission recognizes that the revenues to be collected under the Contract are sufficient for the term of the Contract. In addition, further cost allocations made by the Commission for SoCalGas during the term of this contract shall deem these revenues sufficient to cover an appropriate share of any cost allocations."

PROTESTS

1. Toward Utility Rate Normalization (TURN), the California Industrial Group and California League of Food Processors (CIG/CLFP), and the Division of Ratepayer Advocates (DRA) filed protests and/or comments within the twenty-day protest period provided by General Order 96-A. SoCal responded to the protests on August 24, 1989.

DISCUSSION

1. TURN protests the contract on the grounds that there is no assurance that SoCal obtained the highest possible contract rate.

2. TURN states that since the Commission has not reviewed the impact of the three modifying decisions of D.86-12-009 on long-term contracts, the Commission should look upon any long-term

rate contract not referenced to the ACAP results with extreme caution. TURN recommends full hearing such as that conducted with respect to the San Diego Gas and Electric Company (SDG&E) and Southern California Edison Company (Edison) contracts in Investigation and Suspension (I+S) Case 89-05-016 for SoCal's Advice Letters 1864 and 1872 respectively.

3. Finally, TURN alleges that to the extent that contract revenue shortfalls are allocated to other customers, approval of the agreement would violate the ban on changes in cost allocation methodology set forth in Section 739.6 of the Public Utilities Code.

4. DRA protests the advice filing on several points. First, DRA states that since SoCal is faced with constrained capacity, an issue in I.88-12-027, DRA believes SoCal is imprudent to negotiate long-term contracts at negotiated rates. The costs of added capacity may exceed current embedded costs reflected in tariffed rates. The contract would grant rates even further below cost. DRA protests that SoCal's Advice Letter does not justify Union's threat of bypass. And finally, DRA objects to the language in the filing cited above in Contract Provisions Paragraph 7 concerning acceptance of contract revenues by the Commission.

5. CIG/CLFP comments that the need for discount rates, such as those provided by the contract, reflect present faulty cost allocation methodology "which assigns a disproportionate share of costs to noncore customers." CIG/CLFP also expresses concern with the advice filing language quoted in Paragraph 7 above. CIG/CLFP says that this is the same issue raised in connection with SoCal Advice Letters 1864 and 1872 which were suspended and consolidated for hearing in R.88-08-018, (I+S C.89-05-016).

6. In response, SoCal first states that this contract is different from the suspended SDG&E/Edison contracts in that this Union contract does not involve firm interstate pipeline capacity, storage capacity, or change in end use priority between default rates and the contract.

7. SoCal responds to DRA's protest that it is not certain the the contract will be at a rate below default rates. While the contract rate is presently below the August 1989 default rate, SoCal says it has presented evidence in its pending 1989 ACAP filing that shows a default rate very close to the contract rate.

8. SoCal rejects DRA's recommendation of short term discounts considered through the Annual Cost Allocation Proceeding (ACAP). Union needs longer term information to evaluate its possible investment to convert to butane from one of three nearby or adjacent refineries.

9. Finally, SoCal suggests the long-run marginal cost (LRMC) of service, as shown in its July 14, 1989, filing in I.86-06-005, will be \$0.035 to \$0.050 per therm, which is below the \$0.079 per therm contracted rate.

10. In response to the protestants' broad concerns about pipeline capacity, LRMCs, and changes in Commission policy, the

appropriate forum is proceedings such as I.88-12-027 and R.88-08-018.

11. Decision 89-10-034, dated October 12, 1989, provides guidelines for Commission approval of long-term gas transportation contracts. The Decision specifically addressed a long-term gas transportation contract between Pacific Gas and Electric Company (PG&E) and Mojave Cogeneration Company (Mojave). The Decision ordered future contract advice letter to provide additional information in support of the contract. The Mojave contract was approved because "the Commission discerns that the near term benefits and benefits over the life of the contract seem to outweigh the likelihood of later subsidies."

SUPPLEMENTARY INFORMATION REQUIREMENTS

12. SoCal submitted the following data pursuant to D. 89-10-034, paragraphs entitled "Information Requirements":

1) Estimated contract revenues over the five year term of the contract from 1990 through 1994:

$8,949,000

2) Estimated revenues at default rate, assuming the customer would not bypass from 1990 through 1994:

$9,007,000

3) Estimated long-run marginal cost:

SoCal states, "The long-run marginal cost of transmission capacity is estimated to fall in the range of 2.4 ¢ to 3.4¢ per therm in 1987 constant dollars for the period 1989-1999." Extending this for the estimated volume and the life of the contract yields a LRMC of up to $3,273,000 for five years. ($0.034 per therm x 19,250,000 therms/year x 5 years)

4) Credibility of bypass by Union:

SoCal states that the purpose of the contract is to secure a new large, consistent long-term gas load.

"Before negotiations were initiated, Union Carbide was considering operating the cogeneration plant only as a dispatchable peaking unit for LADWP, while purchasing butane as the primary fuel from an adjacent facility. Union Carbide can easily construct a short butane pipeline to the cogeneration plant. In fact, other facilities located nearby can also provide butane service. It is important to note that other cogenerators in the area currently use butane as a fuel source.

"Under the negotiated contract's stable and competitive rate and provisions requiring 80% take-or-pay of Tier I gas, Union Carbide would base load the cogeneration plant on natural gas. The negotiated contract would prevent Union carbide from operating the plant intermittently on 100% butane. Instead, the cogeneration plant would operate approximately 8,000 hours annually on natural gas."

5) Showing that the contract rate is the highest rate which could be negotiated:

SoCal shows that the contracted rate results in a total estimated cost of natural gas to Union that is within the range of butane prices forecasted for 1990. In summer months the butane price forecast is lower than natural gas prices using the contract transportation rate, while the reverse is true for winter months.

Additionally, the 80% take-or-pay provision will prevent the cogeneration plant from a likely switch to butane during the winter.

6) Estimate of likely ratepayer benefit, gross revenues over five years, 1990 through 1994:

$6,005,000

SoCal develops this estimate based on use of butane in summer months and natural gas in winter months. This mix of fuels will result in about a 2/3 reduction compared with using only natural gas. Reducing the gross revenues by the LRMC of transportation yields about $3,784,000 over the five year term of the contract from 1990 through 1994. [(Contract rate - LRMC) x increase in volume due to contract]

7) Sensitivity of the benefit estimate to variations in price forecasts:

SoCal provides discussion of factors affecting the variables in its forecast of customer benefits, but does not undertake a sensitivity analysis.

13. Commission Advisory and Compliance Division (CACD) notes that SoCal developed the supplemental information under a time constraint. SoCal's response to the requirement of additional data is adequate for this contract. SoCal should continue to work with CACD to develop a more complete presentation, including a sensitivity analysis, to meet further the requirements of D.89-10-034 and thereby assist the Commission in its decision-making process on future contracts.

14. CACD also notes that SoCal has provided its own estimates of marginal cost. These estimates have not yet received Commission review. The use of SoCal's estimates is a short-term expediency acknowledged by D.89-10-034.

15. The difference between the estimated contract revenues and the estimated default revenues represents a possible ratepayer subsidy. In this contract the possible subsidy is very small compared to the estimated ratepayer benefit.

16. With D.89-10-034 as its guideline, CACD recommends approval of the Union contract because there is data showing contract rates greater than the LRMC. Also there is a good likelihood of bypass by the customer to butane. The possible ratepayer benefit is a five-year net revenue of $3,784,000, in 1987 dollars) and there is little evidence of long-term subsidies.

17. The final issue, raised by TURN, CIG/CLFP, and DRA, is the inclusion of language in the Advice Letter, (see page 2, paragraph 7 of this Resolution) that states that the Commission accepts the contract revenues as sufficient and implies that the Commission will not review this contract at a later date. While SoCal asserts that the language is based on D.86-12-009, a portion of D.89-12-009's discussion is omitted in the Advice Letter.[1] Because the protested language does not express the whole concept and does not reflect Commission practice[2], CACD recommends that SoCal remove the language from its Advice Letter.

FINDINGS

1. The protestants' broad concerns about pipeline capacity, LRMCs, and changes in Commission policy will be addressed in other proceedings such as OII.88-12-027 and R.88-08-018.

2. Decision 89-10-034 concerns Commission approval of a long-term gas transportation contract between Pacific Gas and Electric Company and Mojave Cogeneration Company. That contract was approved because "the Commission discerns that the near-term benefits and benefits over the life of the contract seem to outweigh the likelihood of later subsidies." The decision also requires specific information in support of future contracts.

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1 "Contracts having terms of five years or more which are approved by this Commission will normally be considered reasonable and will be taken into account during subsequent cost reallocations occurring during the term of such contracts. *However, we admonish the utilities that our approval will not insulate their shareholders from bearing some of the risks of long-term contracts where it can later be shown that the utility failed to take into account material information of which it was or should have been aware at the time it entered into the contract. Where such information is called to our attention, the utility will bear the burden of showing that projected revenues were maximized at the time the contracts were negotiated* (i.e., that revenues would have been lost if the negotiated rate had been higher or had contained less pricing certainty). This standard is intended to ensure that the utilities will negotiate long-term contracts, consistent with the market realities, in the interest of all utility customers."(at page 41, emphasis added.)

2 "The utilities should not enter into contracts with the expectation that noncore revenue shortfalls can be reallocated to the core market." (D.86-12-009, page 42)

3. The development of the supplemental information and sensitivity analysis required by D.89-10-034 has been under a time constraint. SoCal's response to additional information requirements is adequate to evaluate this contract. SoCal should continue to work with CACD to develop a more complete presentation to aid informed decision making in future contracts.

4. The estimated revenue over the five year term of the contract is $8,949,000.

5. The estimated revenue at default rates, assuming the customer would not bypass is $9,007,000. The difference between the estimated contract revenue and the estimated default revenue is very small. This difference is a measure of possible subsidy by the ratepayers.

6. SoCal estimates its LRMC of transmission capacity in the range of $0.024 to $0.034 per therm for the period of the contract. In I.86-06--005, it estimates its LRMC of service to be $0.035 to $0.050 per therm. Both of these estimates are less than the average contract rate of $0.079 per therm.

7. The use of SoCal's own estimates for LRMC is an expediency acknowledged by D.89-10-034 until the Commission makes a finding on SoCal's LRMC in future decisions.

8. The threat of bypass is credible because a butane source is adjacent to the Union plant site.

9. The estimated ratepayer benefit is $3,784,000 over the life of the contract.

10. Since there is a probable ratepayer benefit and the lack of evidence for a future subsidy, as in D.89-10-034, it is reasonable to approve the Union Contract.

11. Language on page 2, paragraph 4 of the Advice Letter does not state the full position of the Commission and should be removed.

THEREFORE, IT IS ORDERED that:

1. Southern California Gas Company shall remove the 4th paragraph on page two of Advice Letter 1888 by a supplemental Advice filing no later than December 15, 1989.

2. The five-year gas transportation contract between Southern California Gas Company and Union Carbide Industrial Gases, Inc., which is the subject of Advice Letter 1888, is approved and will be effective one day after the filed date of the supplemental advice filing ordered in Paragraph 1 above.

3. The protests of DRA and TURN are denied.

4. The effective date of this Order is today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on December 6, 1989. The following commissioners approved it:

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

Wesley Franklin
Acting Executive Director