PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY
AND COMPLIANCE DIVISION
Energy Branch

RESOLUTION G-3008
September 2, 1992

RESOLUTION

RESOLUTION G-3008. SOUTHERN CALIFORNIA GAS COMPANY REQUESTS AUTHORITY TO IMPLEMENT A SHORT-TERM GAS TRANSPORTATION SERVICE CONTRACT WITH MIDWAY SUNSET COGENERATION COMPANY. BY ADVICE LETTER 2112, FILED ON MAY 6, 1992

SUMMARY

1. By Advice Letter 2112, filed May 6, 1992, Southern California Gas Company (SoCalGas) requests approval of a short-term gas transmission service contract with Midway Sunset Cogeneration Company (Midway).

2. This resolution rejects Advice Letter 2112 without prejudice on the grounds that:

   a. it can not be determined that the Midway bypass would be uneconomic,

   b. the proposed contract represents a deviation from Commission policy because the negotiated transmission rate is well below SoCalGas' system-wide short-run marginal cost,

   c. approval of such a contract would establish a Commission precedent without the benefit of a proceeding, and

   d. approval would serve to preempt pending issues before the Commission.

BACKGROUND

1. On May 6, 1992, SoCalGas filed Advice Letter 2112 requesting approval of a short-term gas transmission service contract with Midway. According to SoCalGas, the purpose of the contract with Midway is to retain marginal revenues which would otherwise be permanently lost if Midway bypassed the SoCalGas system. SoCalGas is seeking approval of the contract which sets the transmission rate of 1.860 cents per decatherm (cents/Dth)

below the system-wide short-run marginal cost (SRMC) which SoCalGas has determined to be 4.69 cents/Dth. SoCalGas does not intend the proposed contract to be subject to a reasonableness review proceeding if approved.

2. The proposed contract is effective on the later of the date of first deliveries, or the effective date of Commission approval. The contract shall continue in effect until the earlier of either the in-service date of compression facilities at the Wheeler Ridge interconnect or one year after the date of first deliveries.

3. Midway, an enhanced oil recovery (EOR) customer in partnership with Sun Oil Company and Mission Energy, is a subsidiary of Southern California Edison Company.

4. Midway's facilities are located approximately 4.5 miles from the Kern River Gas Transmission Company/Mojave Pipeline Company (Kern/Mojave) pipeline. Midway has not yet interconnected with Kern/Mojave.

5. The transmission rate will be increased annually by 2% escalation factor. The maximum daily quantity of gas to be nominated by Midway for delivery by SoCalGas is 23,000 Dth. There is no stated minimum daily quantity. The minimum annual quantity of gas is 3,650,000 Dth. If, at any time during the initial term or for a period of up to 3 years, it is determined by SoCalGas that the transmission charge is not sufficient to cover its costs, SoCalGas will rebill and Midway will pay for all transported quantities a transmission charge not to exceed 4.3 cents/Dth.

6. Additional terms of the proposed contract are found in Attachment 1 of this resolution.

7. The Enhanced Oil Recovery Account (EORA) is a balancing account used to balance recorded EOR revenues with forecasted EOR revenues. Pursuant to the adopted methodology for the accounting treatment of EOR revenues, the system-wide SRMC of 4.69 cents/Dth is used with respect to all revenues in the EOR balancing account. Accordingly, SoCalGas requests that the revenues associated with the proposed short-term contract be accounted for in a separate sub-account of the EORA using the customer-specific SRMC of 1.860 cents/Dth.

8. The provisions of the Contract are predicated on the following circumstances:

a. There exists a very short transmission path of approximately 4.5 miles between Midway's facilities and the Wheeler Ridge interconnect facilities where the Kern/Mojave interstate pipeline will connect with the SoCalGas intrastate system. This "short-haul" from the interconnect to Midway's facility results in lower costs of providing service as compared to service from other interconnects. In addition, continued service by SoCalGas to Midway will result in additional take-away capacity from the Wheeler Ridge interconnect into SoCalGas' system under virtually all operating conditions. This additional take-away capacity is a result of characteristics specific to Midway's location north of the Wheeler Ridge interconnect.

b. Midway's alternative cost to intrastate service is represented by the costs associated with interconnection with Kern/Mojave. This cost establishes a rate of 1.7 cents/decatherm (cents/Dth) as being necessary to compete with Midway's alternative. SoCalGas negotiated a contract transmission charge of 1.860 cents/Dth, which equates to a premium of 9.4% over Midway's alternative.

c. The proposed transmission rate of 1.860 cents/Dth provided under the contract is less than SoCalGas' system-wide SRMC of 4.69 cents/Dth adopted in SoCalGas's 1991 Biennial Cost Allocation Proceeding (BCAP). SoCalGas states that due to the short-haul nature of the service to Midway and the type of service facilities in place at Midway's facility, the actual SRMC cost specific to Midway is significantly less than the adopted system average. SoCalGas estimates that the customer-specific SRMC for Midway is only 1.853 cents/Dth.

9. The proposed transmission rate of 1.860 cents/Dth provides Midway with a reasonable advantage over its competitors as other EOR customers which are similarly situated have the same capability to take direct service from the Kern/Mojave pipeline. According to SoCalGas, this has predominantly been the case as several EOR customers in the San Joaquin Valley have already bypassed their facilities. SoCalGas estimates the volumes of EOR bypass to date at approximately 300 million cubic feet per day (Mmcf/d) and expects this to eventually increase to approximately 325 Mmcf/d.

10. SoCalGas states that the potential annual net marginal revenue (contract revenues less Midway's SRMC) to be retained through the contract is $154,500 of which $146,800 flows back to ratepayers. In decision (D.) 87-05-046, the Commission allocated revenues from EOR negotiated contracts with 5% going to shareholders and 95% to ratepayers.

11. D.86-12-009 requires that long-term (5 years or more) noncore gas transportation agreements be submitted by advice letter for Commission approval. This decision was later modified by D.87-03-044, which required utilities to submit short-term contracts to the Commission Advisory and Compliance Division (CACD), which would make them available for public inspection.

12. Although the Midway contract is a short-term contract, SoCalGas requests prior Commission approval due to its unique discounting of transmission service below system-wide SRMC.

13. Currently, SoCalGas' Application (A.) 90-11-035 is the subject of a Commission proceeding in which SoCalGas seeks approval of its capital investments associated with its interconnect to the Kern/Mojave pipeline. According to interim decision D.92-06-053 completion of the Wheeler Ridge compression facilities is not expected until mid-1993. In that decision, the Commission also approved allocation of available interconnection capacity to "firm access shippers" ahead of "non-firm access shippers" effective from the date the motion was granted, June 17, 1992, through the date on which the compression facilities are placed in service. Midway is currently purchasing gas from a firm access shipper.

14. Currently, SoCalGas and Midway have a long-term contract for gas transmission service which was submitted by Advice Letter 1784 and approved by Commission Resolution G-2790 on May 25, 1988. The terms of this contract comply with SoCalGas Rate Schedule GLT and D.86-12-009, applicable to transportation of customer-owned natural gas for use in EOR facilities.

15. <u>Summary of the Long-term Contract Terms:</u>

a. The term of the contract is 20 years.

b. The customer charge is $500 per premise per month.

c. The transmission charge is 36.75 cents/Dth.

d. The escalation factor in any one contract year is no more than 5% of the current rate and the charge cannot be decreased by more than 5% of the current rate. The rate will never be lower than the Commission's minimum acceptable rate plus .5 cents/therm.

e. There is no fixed demand charge, but, Midway is required to transport-or-pay a quantity not less than 66.67% of its annualized contract quantity.

f. The volumes to be transported under the contract will be a maximum of 68,000 Dth/day for combined steamflood cogeneration use.

16. Under this long-term contract with SoCalGas, Midway is required to transport and/or pay for a quantity of gas not less than 66.67% of its annualized contract quantity. Currently, Midway pays approximately 43.3 cents/Dth, which amounts to a $19,630 daily transport-or-pay obligation. SoCalGas represents that the long-term contract rate is not competitive with Midway's option of taking direct service from the Kern/Mojave pipeline for volumes above the 66.67% transport-or-pay obligation. Therefore, absent a competitive rate, Midway will bypass the SoCalGas system and any potential revenues above the long-term contract transport-or-pay amount will be lost.

17. In addition to the existing long-term contract, there is an existing short-term contract between Midway and SoCalGas. This agreement was executed on February 25, 1992. Service Level 5

transmission service under this short-term contract began on March 1, 1992 and continues from month to month until terminated under Rate Schedule GT-55. Midway can receive a maximum daily quantity of 23,000 Dth/day at a rate of 4.75 cents/Dth.

18. The existing short-term contract states that the agreement is separate and distinct from the existing long-term contract. It is not intended to supersede, modify, or replace the long-term contract.

19. On June 30, 1992, SoCalGas submitted supporting documentation to Advice Letter 2112 as requested by CACD. One document is a letter from Midway indicating the status of the steps necessary for it to begin construction of a gas line to take direct service from the Kern/Mojave interstate pipeline. The other is a copy of the California Energy Commission's (CEC) Order No. 91-11-04(a) amending Midway's Project Conditions of Certification to include a second natural gas pipeline and an additional gas supplier.

20. On July 17, 1992, CACD sent to SoCalGas a data request containing questions related to Advice Letter 2112. SoCalGas sent responses to CACD July 23, 1992 and July 24, 1992.

NOTICE

1. Public notice of this advice letter was made by publication in the Commission calendar, and by SoCalGas's mailing copies to other utilities, governmental agencies, and all interested parties who requested notification.

PROTESTS

1. The Southern California Utility Power Pool (SCUPP) and the Imperial Irrigation District (IID) filed a joint protest to Advice Letter 2112 on May 14, 1992. SCUPP/IID are utility electric generation (UEG) customers. SoCalGas' response was filed on June 2, 1992.

Summary of SCUPP/IID Protest

a. The proposed discounted rate is unduly discriminatory.
b. The Commission should expedite a proceeding to investigate a switch from postage stamp rates on the SoCalGas system to distance-based rates.
c. The Commission should deny SoCalGas' Advice Letter 2112 pending the outcome of such an expedited proceeding.

2. The Commission's Division of Ratepayer Advocates (DRA) filed a protest on May 26, 1992. The SoCalGas response to DRA's protest was filed on June 12, 1992.

Summary of DRA Protest

a. Approval of the proposed contract would set a dangerous precedent.
b. The real costs of service under such a contract are higher than the proposed rate, and higher than the maximum rate which can be charged under the contract.
c. It is not appropriate to use a customer-specific short-run marginal cost.
d. It is likely that SoCalGas customers would be better served if the utility let Midway bypass.
e. The proposed contract establishes a maximum rate of only 4.3 cents/Dth, even if SoCalGas finds that actual costs of service are higher.

DISCUSSION

1. CACD has reviewed Advice Letter 2112 for compliance with Commission policies set forth in previous decisions and resolutions.

2. In D.89-12-045 and D.89-10-034, the Commission has outlined an anti-bypass policy in order to encourage natural gas utilities to negotiate transportation discounts with customers who have the economic incentive to bypass the utilities' systems. This policy pertains to long-term anti-bypass contracts. The Commission requires a strong showing of the following criteria when approving discounted rates and the resulting cost shift to other ratepayer classes:

a. The utility must support the credibility of the customer's bypass threat.

b. The utility must demonstrate that bypass would be uneconomic for ratepayers as a group.

c. The utility must show that the agreement reaches the highest rate that could be negotiated with the customer.

3. Although the Commission adopted these anti-bypass criteria to be applicable to long-term anti-bypass contracts, absent any contrary policy, CACD believes that it is appropriate to apply this criteria to short-term anti-bypass contracts as well.

4. Before consideration of whether the proposed contract satisfies the anti-bypass criteria, the question of the appropriateness of submitting this contract for approval must be addressed.

5. In its protest, DRA states that approval of the contract would set a dangerous precedent for non-EOR customers as well as other EOR customers who may threaten bypassing the SoCalGas system unless they receive treatment similar to Midway. DRA notes that SoCalGas has testified in the Commission's current Long Run Marginal Cost (LRMC) proceeding, Order Instituting

Investigation (I.) 86-06-005, that the bypass threat now realized due to the operation of Kern/Mojave extends to non-EOR customers and that 350 Mmcf/d is in jeopardy of bypass. DRA states that SoCalGas' estimate of $146,800 in revenue contribution of the short-term contract is hardly worth the risk of setting this dangerous precedent when such contracts could ultimately result in lower revenues.

6. In its response to DRA's protest, SoCalGas maintains that the Commission has already established precedent concerning approval of anti-bypass contracts. In both D.86-12-009 and D.89-12-045, the Commission recognized that the purpose of discounted contracts is to attract or retain incremental load which would otherwise be lost. D.90-04-021 recognized the benefit of discounting rates in order to spread fixed costs over a larger amount of throughput, resulting in lower default rates to all ratepayers.

7. SoCalGas states that since virtually all similarly situated SoCalGas customers have left the SoCalGas system DRA's concern has no merit. Current EOR bypass due to the Kern/Mojave Pipeline is now estimated to be approximately 300 Mmcf/d which represents more than 50% of the EOR demand experienced in early 1992 just prior to the completion of the Kern/Mojave Pipeline. The EOR load remaining on the SoCalGas system in San Joaquin Valley is made up almost entirely of long-term contract transport-or-pay volumes. Only a very small portion of the remaining EOR load (less than 10 Mmcf/d, not including Midway) is not being served under long-term contract transport-or-pay requirements.

8. In a joint protest, SCUPP/IID states that it is unduly discriminatory to offer a short-haul rate to one customer while denying distance-based rates to all other customers. SCUPP/IID request that the Commission expedite a proceeding to investigate a switch from postage stamp rates on the SoCalGas system to distance-based rates and that the Midway contract be rejected pending Commission decision on such a proceeding.

9. SoCalGas' response to the SCUPP/IID protests is that the Midway contract was not offered on the basis of transmission path distance, but was offered due to the existence of a viable bypass option. SoCalGas states that the contract is necessary in order to (1) avoid unnecessary load loss, (2) provide for a more fully utilized intrastate system, (3) provide SoCalGas with the opportunity to recover its authorized revenues, and (4) provide incremental revenues, which would otherwise be lost, for the benefit of core customers during subsequent cost reallocations.

10. CACD believes DRA's concern of setting a dangerous precedent and thereby attracting more threats of bypass from non-EOR as well as other EOR customers is unwarranted since the use of negotiated discounted rates has been encouraged and supported by the Commission. Further, CACD believes that SoCalGas' offer of this anti-bypass contract is not unduly discriminatory. As to switching from postage stamp rates to

distance-based rates, SoCalGas and Pacific Gas & Electric (PG&E) have filed A.92-07-047 and A.92-07-049, respectively, requesting the creation of an approval process for discounted long-term contracts to avert the additional threat of uneconomic bypass. CACD suggests SCUPP/IID participate in the proceeding(s) to the extent it wishes to seek change from postage stamp rates to distance-based rates. These applications also request a change of policy with regard to setting a floor rate. Until the Commission has decided these applications, CACD can only continue to apply the anti-bypass criteria mentioned above and other existing Commission policy on negotiated contracts.

11. CACD agrees with SoCalGas that the anti-bypass contract criteria were established to prevent unnecessary discounting of transmission rates. Negotiated contracts must pass this test whether EOR or non-EOR customers threaten to bypass the utility's system. CACD does, however, agree with DRA that a precedent would be established due to the use of a floor rate set at Midway's individual SRMC rather than at the system-wide SRMC. Whether the use of a customer-specific SRMC is a "dangerous" precedent is reserved for later discussion within this Resolution.

VIABILITY OF BYPASS THREAT

12. CACD must address whether SoCalGas has satisfied the first criterion which is to support the credibility of the customer's bypass threat.

13. In determining whether Midway has a credible bypass opportunity, CACD has reviewed SoCalGas' supporting documentation submitted on June 30, 1992. Review of a Midway letter to SoCalGas, dated June 12, 1992, revealed that Midway has obtained the necessary permits to build the connecting bypass line, designed and engineered the line, and secured more than 90% of the right-of-way. Also, Midway has an existing meter run on the Kern River Pipeline at its delivery point as well as an inlet valve in place at its facilities ready to receive the gas. Midway stated that, "... everything is essentially in place except to select the contractor and order the material...".

14. In addition, SoCalGas provided CACD with the California Energy Commission's decision, Order No. 91-1120-04(a), approving Midway's request to install and operate a pipeline to the Kern/Mojave interconnect. In this decision, the CEC found that Midway's proposal was consistent with existing cultural, biological, and engineering certification requirements, that it did not harm the public interest, and that there were no new or additional unmitigated environmental impacts associated with the addition of this connecting pipeline.

15. CACD also reviewed SoCalGas' representation of Midway's cost to build the 4.5 mile short-haul transmission path between Midway's facilities and the Wheeler Ridge interconnect facilities. SoCalGas states that Midway's cost to build the

short-haul is 1.7 cents/Dth, which is well below the transmission rate 43.3 cents/Dth currently charged under the existing long-term contract. SoCalGas negotiated a contract transmission charge of 1.860 cents/Dth.

16. In view of this documentation, CACD believes that Midway's potential to bypass is viable and economically credible.

UNECONOMIC VS. ECONOMIC BYPASS THREAT

17. The second anti-bypass contract criterion is to determine whether the proposed contract is needed to avert uneconomic bypass. Bypass is considered uneconomic when a customer leaves the utility system even though the cost of the bypass is more than the marginal cost of utility service. In this scenario, bypass would be uneconomic to the utility's ratepayers who could still receive some positive contribution if the customer stayed on the utility system and paid a rate less than or equal to the cost to bypass, but still higher than the utility's marginal cost. Economic bypass occurs when a customer's cost to bypass a utility's system is less than the marginal cost needed for the utility to serve this customer. Allowing the customer to bypass would be economic to the utility's ratepayers since no positive contribution can be made if the utility, in order to compete with the customer's cost to bypass, had to offer a negotiated rate which was below the utility's marginal cost needed to serve the customer.

18. The appropriateness of setting the floor rate at customer-specific SRMC must be addressed before it can be determined whether Midway's bypass would be uneconomic to SoCalGas ratepayers.

19. DRA states that it is inappropriate to use customer-specific SRMC and refers to Resolution G-2790 wherein, approving the Midway long-term transportation contract, the Commission noted that the negotiated transmission rate for these contracts should not be set below the SRMC. DRA notes that the Commission was referring to system-wide SRMC, not customer-specific SRMC.

20. In addition, DRA contends that the real costs of service under such contracts may be much greater than the customer-specific SRMC. Additional customers will likely threaten to bypass if they realize that they can bargain for these discounted transportation rates based on customer-specific SRMC. DRA states that it is inappropriate to consider only customer-specific SRMC when potentially large volumes of gas could be subject to bypass where customer-specific SRMCs are used to determine the negotiated rate.

21. In its response, SoCalGas countered that it is entirely appropriate to consider the costs actually necessary to serve the customer for whom uneconomic bypass is an option. SoCalGas states that the actual costs involved in serving a uniquely situated customer such as Midway are necessarily lower than serving others because Midway has a long-term service contract

and SoCalGas must therefore incur costs in serving the customer regardless of the proposed short-term contract. In addition, for this customer, construction of an interconnecting pipeline is economically and logistically feasible (although at a cost which exceeds SoCalGas' cost of serving this customer). SoCalGas says that the rate negotiated with this customer will clearly result in a contribution to fixed costs and will therefore benefit all other customers on the SoCalGas system.

22. In determining whether SoCalGas' use of a customer-specific SRMC is appropriate and whether the Midway bypass would be uneconomic for SoCalGas ratepayers, CACD has reviewed D.86-12-009 which set forth guidelines on implementing rate design for unbundled natural gas utility services. In this decision, the Commission stated,

> Natural gas rate design for the 'noncore' market segment is to be determined primarily by contract negotiation between the utilities and their noncore customers, <u>within a band of flexibility ranging from a ceiling of long-run marginal cost down to a floor of short-run marginal cost</u>... [Emphasis added.]

As noted in this decision, the Commission anticipated that noncore rates would eventually be determined by negotiation and that such negotiated contracts would include a "shortage cost component" which is a direct measure of a customer's value for reliability. The lowest level of reliability was determined to equal the variable cost of transmission, which was at that time about 1.0 cents/therm for <u>each of the utilities</u>. CACD concludes that SRMC has not yet been defined, only approximated by inclusion of the variable costs of transmission as a proxy.

23. Further, the Commission stated

> ... that the negotiated transmission rates specified in long-term contracts should never fall below the utilities' short-run marginal cost during the time period up until the utility forecasts a need to construct additional capacity. After the point at which capacity additions are projected to be necessary, the floor transmission rate should be long-run marginal cost. This is simply good business judgement and sound economic policy. (D.86-12-009, page 68)

24. CACD recognizes that the Commission intended application of these guidelines to be for long-term contracts but believes that for lack of a specific Commission policy, the same guidelines should extend to short-term contracts as well. CACD notes that guidelines and the methodology used to determine a negotiated rate for anti-bypass contracts are the subjects of SoCalGas' and PG&E's applications, A.92-07-047 and A. 92-07-049, respectively, and that it would be inappropriate to assume new guidelines until the Commission has addressed these applications.

25. CACD shares DRA's caution regarding the use of a floor rate set at a customer-specific SRMC. Consideration of a customer's proximity to the potential bypass pipeline may be an appropriate

factor in determining a negotiated rate; however, CACD cannot, at this time, determine the appropriateness of deviating from the Commission's current policy.

26. The Commission approximated SRMC by requiring contracts to include system-wide variable costs of transmission. Although CACD recognizes that SoCalGas' Advice Letter 2112 attempts to demonstrate that SRMC is covered, CACD believes that these calculations cannot and should not be evaluated at this time for the following reasons:

> First, SRMC is not defined, only approximated, so it is uncertain that the contract will provide any net benefit to core ratepayers.
>
> Second, D.86-12-009 specifically states that negotiated transmission rates specified in long-term contracts "should never fall below the <u>utilities'</u> short-run marginal cost during the time period up until the utility forecasts a need to construct additional capacity." [Emphasis added.] SoCalGas has negotiated a short-term contract well below the system-wide SRMC of 4.69 cents/Dth.

27. In determining whether Midway's bypass would be uneconomic to SoCalGas' ratepayers, CACD has reviewed Commission Resolution G-2930, which clarified the definition of uneconomic bypass:

> Uneconomic bypass occurs when a customer leaves the utility system even though the customer's alternative energy source costs more than the marginal cost of utility service. That is, ratepayers could receive some positive margin contribution from the potential bypasser by offering a rate less than or equal to the bypass cost, but still higher than utility marginal cost.

28. The Commission has not established a policy for short-term anti-bypass contracts. Absent a definitive policy, CACD supports the use of criteria established for long-term contracts. This criteria used system-wide SRMC as the floor rate for negotiated contracts. CACD interprets "marginal cost" to include variable transmission costs and, therefore, concludes that SoCalGas' use of customer-specific SRMC is inappropriate in determining whether it is economic or uneconomic for Midway to bypass the SoCalGas system. CACD believes that SoCalGas' use of Midway's customer-specific SRMC does not follow the guidelines set forth by the Commission.

<u>THE NEGOTIATED RATE</u>

29. CACD believes it is unnecessary to present a detailed discussion of whether the proposed transmission rate reaches the highest rate that could be negotiated with the customer since SoCalGas has failed to demonstrate that Midway's bypass would be uneconomic. As discussed earlier, CACD believes that SoCalGas

did not follow the established Commission policy with regard to the floor rate of a negotiated transportation contract.

OTHER ISSUES

30. In the current LRMC proceeding, I.86-06-005, the Commission is determining the cost components of providing service to customers. In calculating Midway's SRMC, SoCalGas has estimated some of the same components. Therefore, CACD believes that approval of the proposed contract and with it, Midway's estimated SRMC at this time could prejudice the LRMC proceeding.

31. Additionally, in Advice Letter 2112, SoCalGas has attempted to influence the Commission to change policy in an inappropriate forum. By General Order 96-A, Section X., a utility cannot make effective any deviation from Commission policy unless it first obtains Commission authorization to carry out the terms of such contract, arrangement or deviation. This request for authorization must be made by formal application in accordance with the Commission's Rules of Practice and Procedure, "... except that where the service is of minor importance or temporary in nature, the Commission may accept an application and showing of necessity by Advice Letter." Through the application process all interested parties have the opportunity to participate and the Commission will have the opportunity to more fully consider the effects of such a policy change. In view of this, CACD believes the Commission's application process is the appropriate forum in which to deviate from Commission policy on contracts and to address the issue of using customer-specific SRMC as the floor for negotiated rates.

32. CACD suggests that the Commission reject this Advice Letter without prejudice and encourage all parties to participate in the application process for anti-bypass contracts filed before the Commission as A.92-07-047 and A.92-07-049.

FINDINGS

1. On May 6, 1992, SoCalGas filed Advice Letter 2112 requesting approval of a short-term gas transmission service contract with Midway. According to SoCalGas, the purpose of the contract with Midway is to retain marginal revenues which would otherwise be permanently lost if Midway bypassed the SoCalGas system.

2. SoCalGas is seeking approval of the contract which sets the transmission rate of 1.860 cents per decatherm (cents/Dth) below the system-wide SRMC which SoCalGas has determined to be 4.69 cents/Dth.

3. SoCalGas does not intend the proposed contract be subject to a reasonableness review proceeding if approved.

4. The proposed contract is effective on the later of the date of first deliveries, or the effective date of Commission

approval. The contract shall continue in effect until the earlier of either the in-service date of compression facilities at the Wheeler Ridge interconnect or one year after the date of first deliveries.

5. Midway, an enhanced oil recovery (EOR) customer in partnership with Sun Oil Company and Mission Energy, is a subsidiary of Southern California Edison Company.

6. Midway's facilities are located approximately 4.5 miles from the Kern River Gas Transmission Company/Mojave Pipeline Company (Kern/Mojave) pipeline. Midway has not yet interconnected with Kern/Mojave.

7. The transmission rate will be increased annually by 2%.

8. The maximum daily quantity of gas to be nominated by Midway for delivery by SoCalGas is 23,000 Dth. There is no stated minimum daily quantity. The minimum annual quantity of gas is 3,650,000 Dth.

9. If, at any time during the initial term or for a period of up to 3 years, it is determined by SoCalGas that the transmission charge is not sufficient to cover its costs, SoCalGas will rebill and Midway will pay for all transported quantities a transmission charge not to exceed 4.3 cents/Dth.

10. SoCalGas requests that the revenues associated with the proposed short-term contract be accounted for in a separate sub-account of the Enhanced Oil Recovery Account using the customer-specific SRMC of 1.860 cents/Dth.

11. Midway's facilities are located approximately 4.5 miles from the Wheeler Ridge interconnect facilities where the Kern/Mojave interstate pipeline will connect with the SoCalGas intrastate system. This "short-haul" from the interconnect to Midway's facility results in lower costs of providing service as compared to service from other interconnects. Midway has not yet interconnected with the Kern/Mohave interconnection.

12. Due to characteristics specific to Midway's location north of the Wheeler ridge interconnect, continued service by SoCalGas to Midway will result in additional take-away capacity from the Wheeler Ridge interconnect into SoCalGas' system under virtually all operating conditions.

13. Midway's alternative cost to intrastate service is represented by the costs associated with interconnection with Kern/Mojave. This cost establishes a rate of 1.7 cents/decatherm (cents/Dth) as being necessary to compete with Midway's alternative.

14. The proposed transmission rate of 1.860 cents/Dth provided under the contract is less than SoCalGas' system-wide short-run marginal cost of 4.69 cents/Dth adopted in SoCalGas's 1991 Biennial Cost Allocation Proceeding (BCAP).

15. SoCalGas states that due to the short-haul nature of the service to Midway and the type of service facilities in place at Midway's facility, the actual SRMC cost specific to Midway is significantly less than the adopted system average. SoCalGas estimates that the customer-specific SRMC for Midway is only 1.853 cents/Dth.

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18. D.87-03-044 required utilities to submit short-term contracts to CACD, which would make them available for public inspection.

19. Although the Midway contract is a short-term contract, SoCalGas requests prior Commission approval due to its unique discounting of transmission service below system-wide SRMC.

20. SoCalGas' application A.90-11-035 is the subject of a Commission proceeding in which SoCalGas seeks approval of its capital investments associated with its interconnect to the Kern/Mojave pipeline. According to interim decision D.92-06-053 completion of the Wheeler Ridge compression facilities is not expected until mid-1993.

21. Midway is currently purchasing gas from a firm access shipper.

22. SoCalGas and Midway have a 20-year long-term contract for gas transmission service under which Midway pays approximately 43.3 cents/Dth. Midway is required to transport-or-pay a quantity not less than 66.67% of its annualized contract quantity.

23. SoCalGas and Midway have an existing short-term contract which began on March 1, 1992 and continues from month to month until terminated under Rate Schedule GT-55. Midway can receive a maximum daily quantity of 23,000 Dth/day at a rate of 4.75 cents/Dth. It is not intended to supersede, modify, or replace the long-term contract.

24. SCUPP/IID, utility electric generation customers, filed a joint protest with the following concerns:

a. The proposed discounted rate is unduly discriminatory.
b. The Commission should expedite a proceeding to investigate a switch from postage stamp rates on the SoCalGas system to distance-based rates.
c. The Commission should deny SoCalGas' Advice Letter 2112 pending the outcome of such an expedited proceeding.

25. In its protest, DRA argued that:

a. Approval of the proposed contract would set a dangerous precedent.
b. The real costs of service under such a contract are higher than the proposed rate, and higher than the maximum rate which can be charged under the contract.
c. It is not appropriate to use a customer-specific short-run marginal cost.
d. It is likely that SoCalGas customers would be better served if the utility let Midway bypass.
e. The proposed contract establishes a maximum rate of only 4.3 cents/Dth, even if SoCalGas finds that actual costs of service are higher.

26. In D.89-12-045 and D.89-10-034, the Commission has outlined an anti-bypass policy in order to encourage natural gas utilities to negotiate transportation discounts with customers who have the economic incentive to bypass the utilities' systems. The Commission requires a strong showing of the following criteria when approving discounted rates and the resulting cost shift to other ratepayer classes:

a. The utility must support the credibility of the customer's bypass threat.

b. The utility must demonstrate that bypass would be uneconomic for ratepayers as a group.

c. The utility must show that the agreement reaches the highest rate that could be negotiated with the customer.

27. Absent any contrary policy, the long-term anti-bypass criteria should apply to short-term anti-bypass contracts.

28. DRA's concern of setting a dangerous precedent and thereby attracting more threats of bypass from non-EOR as well as other EOR customers is unwarranted since the use of negotiated discounted rates has been encouraged and supported by the Commission.

29. SoCalGas' offer of this anti-bypass contract is not unduly discriminatory.

30. SoCalGas and PG&E have filed A.92-07-047 and A.92-07-049, respectively, requesting the creation of an approval process for discounted long-term contracts to avert the additional threat of uneconomic bypass. These applications also request a change of policy with regard to setting a floor rate.

31. Anti-bypass contract criteria were established to prevent unnecessary discounting of transmission rates. Negotiated contracts must pass this test whether EOR or non-EOR customers threaten to bypass the utility's system.

32. The use of a floor rate set at Midway's individual SRMC rather than at the system-wide SRMC would improperly establish a Commission precedent without the benefit of a proceeding.

33. Midway has obtained the necessary permits to build the connecting bypass line, designed and engineered the line, and secured more than 90% of the right-of-way. Also, Midway has an existing meter run on the Kern River Pipeline at its delivery point as well as an inlet valve in place at its facilities ready to receive the gas.

34. The California Energy Commission's decision, Order No. 91-1120-04(a), approved Midway's request to install and operate a pipeline to the Kern/Mojave interconnect.

35. Midway's cost to build the short-haul is 1.7 cents/Dth, which is well below the transmission rate 43.3 cents/Dth currently charged under the existing long-term contract. SoCalGas negotiated a contract transmission charge of 1.860 cents/Dth.

36. Midway's potential to bypass is viable and economically credible.

37. Bypass is considered uneconomic when a customer leaves the utility system even though the cost of the bypass is more than the marginal cost of utility service.

38. Economic bypass occurs when a customer's cost to bypass a utility's system is less than the marginal cost needed for the utility to serve this customer.

39. Commission decision D.86-12-009 required that negotiated transmission rates specified in long-term contracts should never fall below the utilities' short-run marginal cost until pipeline capacity additions are projected to be necessary and then the floor transmission rate should be long-run marginal cost.

40. Absent a specific Commission policy, the same long-term guidelines for a floor rate should extend to short-term anti-bypass contracts as well.

41. It would be inappropriate to assume new guidelines until the Commission has addressed SoCalGas' and PG&E's applications, A.92-07-047 and A. 92-07-049, respectively.

42. Consideration of a customer's proximity to the potential bypass pipeline may be an appropriate factor in determining a negotiated rate; however, the appropriateness of deviating from the Commission's current policy cannot at this time be determined.

43. The Commission approximated SRMC by requiring contracts to include system-wide variable costs of transmission.

44. SRMC is not defined, only approximated, so it is uncertain that the contract will provide any net benefit to core ratepayers.

45. D.86-12-009 specifically states that negotiated transmission rates specified in long-term contracts "should never fall below the utilities' short-run marginal cost during the time period up until the utility forecasts a need to construct additional capacity." [Emphasis added.] SoCalGas has negotiated a short-term contract well below the system-wide SRMC of 4.69 cents/Dth.

46. The Commission has not established a policy for short-term anti-bypass contracts. Absent a definitive policy, criteria used to evaluate long-term contracts should be applied to short-term contracts. This criteria uses system-wide SRMC as the floor rate for negotiated contracts.

47. SoCalGas' use of customer-specific SRMC is inappropriate in determining whether it is economic or uneconomic for Midway to bypass the SoCalGas system. SoCalGas' use of Midway's customer-specific SRMC does not follow the guidelines set forth by the Commission.

48. Detailed discussion of whether the proposed transmission rate reaches the highest rate that could be negotiated with the customer is unnecessary as SoCalGas' use of a customer-specific SRMC represents a deviation from Commission policy.

49. The Commission is currently determining the cost components of providing service to customers in the LRMC proceeding, I.86-06-005. In calculating Midway's SRMC, SoCalGas has estimated some of the same components.

50. Approval of the proposed contract could prejudice the LRMC proceeding.

51. SoCalGas has attempted to influence the Commission to change policy in an inappropriate forum.

CONCLUSIONS

1. Absent a separate policy, the Commission should apply the anti-bypass policy and criteria as detailed in Commission decisions, D.89-12-045 and D.89-10-034, to be applicable to short-term anti-bypass contracts.

2. Until the Commission has decided the SoCalGas and PG&E applications, A.92-07-047 and A.92-07-049, CACD should, in its review of anti-bypass contracts filed via advice letters, continue to apply the anti-bypass criteria and other existing Commission policy on negotiated contracts.

3. SCUPP/IID should support the proceeding(s) addressing the SoCalGas and PG&E applications A.92-07-047 and A.92-07-049 to

the extent it wishes to seek change from postage stamp rates to distance-based rates.

4. Pending final decision(s) and or action(s) in Commission's proceedings on Long-Run Marginal Cost, I.86-06-005, and on the SoCalGas and PG&E applications, A.92-07-047 and A.92-07-049, respectively, SoCalGas should apply to both short- and long-term anti-bypass contracts the guidelines detailed in D.86-12-009 where the negotiated transmission rate should fall within the band of flexibility ranging from a ceiling of long-run marginal cost down to a floor of system-wide short-run marginal cost.

5. The Commission should not approve the proposed SoCalGas/Midway short-term contract for the following reasons:

First, SoCalGas' calculation of Midway's transmission rate based on customer-specific short-run marginal cost is not appropriate in determining whether the Midway bypass would be uneconomic to SoCalGas' ratepayers nor can it be determined that the contract will provide any net benefit to core ratepayers.

Second, D.86-12-009 specifically states that negotiated transmission rates specified in long-term contracts "should never fall below the utilities' short-run marginal cost during the time period up until the utility forecasts a need to construct additional capacity." SoCalGas has negotiated a short-term contract well below the system-wide SRMC of 4.69 cents/Dth.

Third, approval of a negotiated transmission rate which set as the floor rate the customer-specific short-run marginal cost SRMC would bias the Commission's current LRMC proceeding, I.86-06-005.

6. Additionally, SoCalGas should utilize the Commission's application process which would be the appropriate forum in which to deviate from Commission policy on contracts and to address the issue of using a customer-specific short-run marginal cost as the floor rate for negotiated rates.

7. The Commission should reject this Advice Letter without prejudice and encourage all parties to participate in the application process for anti-bypass contracts filed before the Commission as A.92-07-047 and A.92-07-049.

THEREFORE, IT IS ORDERED that:

1. The anti-bypass policy and criteria as detailed in Commission decisions, D.89-12-045 and D.89-10-034, shall be applicable to short-term anti-bypass contracts.

2. Review of anti-bypass contracts via advice letter shall continue to include the anti-bypass criteria and other existing

Commission policy on negotiated contracts, pending Commission action or a final decision on the Southern California Gas Company and Pacific Gas & Electric applications, A.92-07-047 and A.92-07-049.

3. The Commission encourages the Southern California Utility Power Pool and the Imperial Irrigation District to support the proceeding(s) addressing the Southern California Gas Company and Pacific Gas & Electric applications A.92-07-047 and A.92-07-049 to the extent it wishes to seek change from postage stamp rates to distance-based rates.

4. Southern California Gas Company shall apply the guidelines detailed in D.86-12-009 to both short- and long-term anti-bypass contracts pending final decision(s) and or action(s) in Commission's proceedings on Long-run Marginal Cost, I.86-06-005, and on the SoCalGas and PG&E applications, A.92-07-047 and A.92-07-049, respectively.

5. The short-term gas transportation contract between Southern California Gas Company and Midway Sunset Cogeneration Company, which is the subject of Advice Letter 2112, is rejected without prejudice.

6. This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on September 2, 1992. The following Commissioners approved it:

Neal J. Shulman

Executive Director

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
NORMAN D. SHUMWAY
Commissioners

Commissioner Patricia M. Eckert, being necessarily absent, did not participate.

ATTACHMENT 1

Summary of Terms from the Proposed Short-term Contract

a. The contract is effective on the later of the date of first deliveries, or the effective date of Commission approval. The contract shall continue in effect until the earlier of either the in-service date of compression facilities at the Wheeler Ridge interconnect or one year after the date of first deliveries.

b. The maximum daily quantity of gas to be nominated by Midway for delivery by SoCalGas is 23,000 decatherms (Dth). There is no stated minimum daily quantity. The minimum annual quantity of gas is 3,650,000 Dth.

c. If in any month gas is delivered to Midway in addition to the gas accepted for transportation for that month, such gas quantities shall be deliveries pursuant to the existing long-term Gas Transmission Service Contract between Midway and SoCalGas dated February 26, 1988 and shall be billed accordingly.

d. Midway will pay a transmission charge of 1.860 cents per decatherm (cents/Dth) of gas delivered, which will be increased annually by a 2% escalation factor.

e. If, at any time during the initial term or for a period of up to 3 years, it is determined by SoCalGas that the transmission charge is not sufficient to cover its costs, SoCalGas will rebill and Midway will pay for all all transported quantities a transmission charge not to exceed 4.3 cents/Dth.

f. The transmission charge must not be lower than SoCalGas' costs allocated to this type of service. If the transmission charge is lower than SoCalGas' costs, either party may terminate the contract.

g. If SoCalGas accepts deliveries of Midway's gas but cannot redeliver this gas to Midway, SoCalGas agrees to purchase the overdelivered gas at the lower of the then current core subscription weighted average cost of gas or the average cost of SoCalGas' short term gas purchases for that month.

h. The proposed contract is considered null and void if the Commission has not given express approval within four months of the date of execution, April 16, 1992.

(End of Attachment 1)