PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION

RESOLUTION G-3242
APRIL 1, 1999

RESOLUTION

RESOLUTION G-3242. SOUTHERN CALIFORNIA GAS COMPANY. APPROVES AUTHORIZATION TO ESTABLISH A SINGLE CUSTOMER CLASS FOR ALL ELECTRICITY GENERATORS IN ITS SERVICE TERRITORY AND TO ELIMINATE THE COLLATERAL DISCOUNT RULE. PROVISIONALLY APPROVES REQUEST TO ELIMINATE THE COGENERATOR GAS ALLOWANCE.

BY ADVICE LETTER 2709, FILED ON MAY 5, 1998.

SUMMARY

1. By Advice Letter (A.L.) 2709, filed May 5, 1998, Southern California Gas Company (SoCalGas) submits for filing and approval with the Commission a request to establish a single customer class for all electricity generators in SoCalGas' service territory. In conjunction with that request, SoCalGas is proposing:

a) to eliminate the special conditions in its transmission service rate schedules that require it to offer the same or comparable rates to cogeneration customers in the event a rate design agreement is negotiated with a utility electric generation (UEG) customer (the so-called Collateral Discount Rule);

b) to eliminate (in conjunction with a) above) the requirement to adjust the tariff rates for cogeneration customers whenever a discounted transmission contract with a UEG customer becomes effective or expires; and

c) to set a sunset date at the end of the Global Settlement term (August 1, 1999) for the methodology used to determine the volume of transmission service to cogenerators that is eligible to receive the cogenerator parity rate; this volume is termed the Cogenerator Gas Allowance (CGA).

2. The Energy Division received several protests to A.L. 2709. The Office Of Ratepayer Advocates (ORA) submitted a limited protest; the Southern California Utility Power Pool and the Imperial Irrigation District (SCUPP/IID) filed a joint letter partially in support and partially in protest of the A.L. In a subsequent filing, SCUPP/IID scaled back the scope of its protest. The California Cogeneration Council and Watson Cogeneration Company (CCC/Watson) filed a joint letter in support of A.L. 2709, but cautioned that the advice letter should be adopted in its entirety and without modification.

3. This Resolution provisionally approves A.L. 2709. SoCalGas' requests to establish a single customer class for all electricity generators in its service territory and to eliminate the Collateral Discount Rule (CDR) are approved. SoCalGas' request to set a sunset date of August 1, 1999 for the methodology to determine the Cogenerator Gas Allowance is provisionally approved. As discussed later in this Resolution, the Commission is concerned that, absent the CGA, gas users could "game" the system by installing small generators, thereby receiving all of their gas at the reduced electricity generation (EG) transportation rate. In its 1999 BCAP (A.98-10-012), SoCalGas is addressing at least some of the issues necessary to prevent this type of "gaming." If it has not already done so, SoCalGas is ordered to present, during its 1999 BCAP, a completed proposal to address these concerns. If this Commission does not adopt comprehensive anti-gaming safeguards by August 1, 1999 (the termination date of the CGA set forth in the Global Settlement), the CGA will continue in effect until such safeguards are adopted.

4. A "companion" Resolution, G-3243 for A.L. 2701, discusses the appropriateness of recalculating the CDR due to the sale of Edison's Mandalay generating facility. That Resolution has been rendered moot due to the elimination of the CDR in this Resolution.

BACKGROUND

1. SoCalGas filed A.L. 2709 on May 5, 1998, proposing to establish a single customer class for all electricity generators in SoCalGas' service territory. This filing was made in compliance with Decision (D.) 98-03-073, which directed SoCalGas to adopt such a class.

2. In conjunction with adoption of the single customer class for electric generation, SoCalGas also requests that the Collateral Discount Rule be immediately eliminated. Public Utilities Code Section 454.4 (PU Code §454.4) requires that rates for gas that is utilized by cogenerators shall not be higher than the rates established for gas utilized as a fuel by an electric plant. Because of this code section, SoCalGas includes in its rate schedules the special condition that it will adjust the default rate for cogeneration customers whenever a discounted transmission contract with a UEG customer becomes effective or expires. As a result of this requirement, any discount for gas transmission service extended to a UEG customer results in an effective "collateral discount" for all cogeneration customers that receive service at tariffed rates.

3. PU Code §454.4 limits the volume of gas used by cogenerators that is eligible for the UEG rate to "that quantity of gas which an electrical corporation serving the area where a cogeneration technology project is located, or an equivalent area, would require in the generation of an equivalent amount of electricity." The volume of gas used by a cogenerator that is eligible for the UEG rate is called the Cogeneration Gas Allowance (CGA) in SoCalGas' tariffs. In order to comply with the statutory requirements, SoCalGas' tariff provides that a cogenerator's CGA shall be calculated by multiplying the kilowatt hours generated by the cogenerator by the local UEG's incremental heat rate, including transmission line losses. Cogenerator volumes in excess

of the CGA are billed at the otherwise applicable rate. In its A.L. 2709, SoCalGas requests that the CGA be eliminated at the end of the Global Settlement term (August 1, 1999).

4. SoCalGas offers separate rates for core subscription, firm transmission, and interruptible transmission service to UEG customers. Service to these customers is exempt from the California Alternate Rates for Energy (CARE) surcharge; in D.89-09-044, the Commission specifically exempted UEG and cogeneration customers from funding the CARE program to avoid double payment by electric ratepayers. In A.L. 2709, SoCalGas proposes that the new tariffs would continue to be exempt from the CARE surcharge.

NOTICE

1. Advice Letter 2709 was served on other utilities, government agencies, and to all interested parties who requested such notification, in accordance with the requirements of General Order 96-A. Public notice of this filing has been made by publication in the Commission's calendar.

PROTESTS

1. On May 26, 1998, ORA filed a limited protest to A.L. 2709. ORA expresses concern over the termination date for the Cogeneration Gas Allowance. ORA recommends that the termination date of August 1, 1999 be deleted. ORA believes that this issue should be addressed in a subsequent proceeding.

2. Also on May 26th, SCUPP/IID filed a letter that partially supported and partially protested the advice letter. Like ORA, SCUPP/IID protest SoCalGas' proposal to sunset the Cogeneration Gas Allowance at the end of the Global Settlement term (August 1, 1999). SCUPP/IID protest other aspects of A.L. 2709, but in their supplemental protest on June 22, 1998, the additional protests were withdrawn.

3. Finally, also on May 26th, CCC/Watson filed a letter strongly supporting SoCalGas' advice letter, urging that it be adopted in its entirety without modification.

4. In SoCalGas' reply (filed June 9, 1998) to ORA's and SCUPP/IID's protests, SoCalGas outlined why it believed A.L. 2709 should be approved as submitted.

5. Also on June 9th, CCC/Watson filed a response to ORA's and SCUPP/IID's protests.

6. On June 22, 1998, SCUPP/IID filed a supplement to their May 26, 1998 protest. SCUPP/IID note that General Order 96-A does not provide for the filing of supplemental protests. However, since this new filing contains no new arguments, and since it scales back the areas of protest contained in their original May 26th filing, the Commission will accept this supplemental protest.

7. Also on June 22, 1998, SoCalGas sent a letter urging the Commission to ignore SCUPP/IID's letter of the same date.

DISCUSSION

1. Edison and PG&E are currently in the process of divesting their California-based fossil-fuel plants. Divestiture creates a significant nonutility power industry in California that is not subject to regulation by the Commission. The creation of a single electricity generation (EG) customer class complies with D.98-03-073 (the merger decision for Pacific Enterprises and Enova) which directed the establishment of such a class. None of the protests received by the Energy Division object to the establishment of the single EG class. Consistent with the position of all the parties, the EG class should be exempt from paying the CARE surcharge.

2. None of the parties object to SoCalGas' proposal to remove from its rate schedules the special condition that SoCalGas offer the same or comparable rates to cogeneration customers in the event a rate design agreement is negotiated with a UEG customer. SCUPP/IID and CCC/Watson discuss at length how this so-called Collateral Discount Rule (CDR) relates to PU Code §454.4.

3. In relevant part, PU Code §454.4 states, "The commission shall establish rates for gas which is utilized in cogeneration technology projects not higher than the rates established for gas utilized as a fuel by an electric plant in the generation of electricity." SCUPP/IID argue that PU Code §454.4 makes no mention of discounted contracts, and certainly does not require that utilities adjust cogenerator rates to reflect discounts negotiated with UEGs; they apparently believe that §454.4 only applies to the initial setting of tariff rates. CCC/Watson acknowledge the relevance of §454.4, but believe that the Commission has the ability to "liberally" interpret it and not require the CDR. ORA does not discuss this issue.

4. We agree with the parties that the CDR is no longer required. This belief is based on two precepts. First, the changing regulatory environment has rendered §454.4 impossible to implement on a long-term basis. There are no longer any UEGs operating in SoCalGas' service territory; therefore, there is no need for a CDR to protect cogenerators from discounts negotiated by UEGs. Second, D.98-03-073 (the SoCalGas/SDG&E merger decision) established a single customer class for all electricity generators. (Finding of Fact Nos. 90, 91, and 92) Maintaining the CDR would create two separate EG rates: 1) cogeneration customers who continue to receive the Collateral Discount Rate, and 2) everyone else. We interpret the merger decision to require a single EG rate; the only way to accomplish that is to abolish the CDR.

5. Both ORA and SCUPP/IID object to SoCalGas' proposal to sunset the Cogeneration Gas Allowance (CGA) at the end of the Global Settlement term (August 1, 1999); CCC/Watson strongly support the proposal. Once again, the interpretation of PU Code §454.4 enters into the parties' arguments on this subject.

6. In discussing the quantity of gas eligible for cogeneration rates, §454.4 states, in relevant part, "This rate shall apply only to that quantity of gas which an electrical corporation serving the area where a cogeneration technology project is located, or an equivalent area, would require in the generation of an equivalent amount of electricity based on the corporation's average annual incremental heat rate and reasonable transmission losses or that quantity of gas actually consumed by the cogeneration technology project in the sequential production of electricity and steam, heat, or useful work, whichever is the lower quantity." SCUPP/IID argue that §454.4 expressly limits the volume of gas used by a cogenerator; the CGA cap is not optional. Without the allowance, all cogenerator volumes would be eligible for the default rate effective August 1, 1999. ORA has similar concerns; it recommends that the termination date of August 1, 1999 be deleted from SoCalGas' proposal. ORA argues that the method currently used to determine which loads qualify for the cogeneration rate schedule be maintained until the Commission reexamines this issue in a subsequent proceeding.

7. CCC/Watson take the opposite position regarding the CGA. They claim that the Commission's original adoption of the CGA was based on the premise that, under "avoided-cost principles," cogenerators that sell electricity to the UEGs only should qualify for the UEG rate to the extent that they displace UEG generation. They further argue that, in light of the divestiture of gas-fired generation and the restructuring of the electricity market, avoided-cost pricing for cogenerators will no longer be based upon the actual efficiency ratings of the purchasing utilities; consequently there is no basis for tying cogenerators' gas rates to the efficiency of the purchasing utilities, and the CGA is no longer applicable.

8. Balancing the concerns of SoCalGas, CCC/Watson, ORA, and SCUPP/IID, we provisionally approve the termination of the CGA at the end of the Global Settlement term (August 1, 1999), but only if we have by that time adopted comprehensive anti-gaming safeguards. Once again, we believe that this new era of deregulation has rendered portions of §454.4 impossible to implement on a long-term basis. As mentioned above, there are no longer any UEGs remaining in SoCalGas' service territory. The divested UEGs are now considered Exempt Wholesale Generators (EWGs). In Decision 95-12-007, Conclusion of Law No. 17 finds that the regulation of EWGs would conflict with Federal jurisdiction. Since UEGs no longer exist, and since the Commission does not regulate EWGs, there are no longer any generating "entities" that can provide the incremental heat rates necessary to compute the CGA. Since it is now impossible to calculate the CGA, we believe it is appropriate to eliminate the CGA effective on August 1, 1999 as SoCalGas proposes. However, this approval is provisional. Absent the CGA (or an equivalent safeguard), current large users of natural gas could have the incentive to install small cogenerator units so as to receive all of their gas at a reduced rate. As an extreme example, an existing large processing plant could install a small bottoming cycle unit to generate a small amount of electricity with its waste heat. Absent the CGA, it would then be eligible to receive all of its gas at the lower rate. Such an extreme scenario may or may not actually take place. However, we are concerned that the potential for "gaming the system" will present itself as a tempting option if safeguards are not in place by the time the CGA is eliminated.

9. In its current 1999 BCAP (A.98-10-012), SoCalGas is addressing at least some of the issues necessary to prevent this type of "gaming." If it has not already done so, SoCalGas must present, during its 1999 BCAP, a completed proposal to address these concerns. If this Commission does not adopt a completed proposal by August 1, 1999 (the termination date of the CGA), we will extend the term of the CGA until such safeguards are adopted and in place.

10. ORA's May 26, 1998 protest regarding the termination date of the CGA should be granted.

11. SCUPP/IID's June 22, 1998 supplemental protest regarding the termination date of the CGA should be denied. Their request to eliminate the collateral discount should be granted.

COMMENTS

1. The Draft Alternate Resolution of the Energy Division in this matter was mailed to the parties in accordance with PU Code Section 311(g). Comments were filed on March 25, 1999 by SoCalGas, CCC/Watson, and SCUPP/IID. The remainder of this section discusses the comments submitted by each party.

2. SoCalGas: In its comments, SoCalGas expresses general support for the draft Alternate Resolution. They did recommend one area of modification. SoCalGas states:

> *However, Section 454.4 does not restrict the Commission's normal ratemaking discretion with respect to any volumes of gas delivered for cogeneration in excess of this amount. Section 454.4 does not say that cogeneration volumes in excess of this amount cannot be charged the same rate as UEGs pay. The Alternate should be modified to state that Section 454.4 does not prevent the Commission from setting the rate for cogeneration use above the CGA equal to the rate applicable to other electric generation use.*

3. We agree that the Commission has the ratemaking authority to set rates above the CGA equal to the rates below. We also agree that such a regulatory scheme would effectively render moot the need for the CGA. However, we see no reason to set rates in such a fashion, and we are concerned over the implications of such ratemaking. We believe that we have a more satisfactory response to the problem of implementing §454.4 as drafted given the absence of UEGs. We find no reason to make the language modifications suggested by SoCalGas.

4. CCC/Watson: In its comments, CCC/Watson also express general support for the draft Alternate Resolution. Like SoCalGas, they would like to see the draft Alternate modified to include the statement that the Commission has the authority to set rates for volumes in excess of the CGA equal to rates for volumes below the CGA. As was discussed above, we decline to make such a statement.

5. SCUPP/IID: In their comments, SCUPP/IID allege that the draft Alternate Resolution contains legal error with respect to the proposal to terminate the CGA. SCUPP/IID state:

> *Unlike the CDR, the CGA is a matter of statutory law. Specifically, the CGA is required by the express language of §454.4 of the Public Utilities Code. Indeed, the very formula for calculating the CGA is set forth in the statute. Accordingly, the CGA cannot be terminated by Commission decision: termination requires legislative action.*

6. The comment set forth above does not correctly characterize the actions proposed in the Alternate Resolution. We recognize that §454.4 is a statute which requires us to establish a cogenerator gas rate which is no higher than the rate for gas used by electric plants to generate electricity, and which limits the application of that cogenerator gas rate to the lesser of two quantities of gas: 1) the quantity of gas that an electric corporation would require to produce an amount of electricity equal to that produced by the cogenerator, or 2) the amount of gas actually used be the cogenerator in the sequential production of electricity and steam, heat, or useful work. Section 454.4 requires that the quantity of gas which would be used by an electric corporation to generate an equivalent amount of electricity be determined on the basis of a corporation's annual incremental heat rate and reasonable transmission loses. Historically, the incremental heat rates of the utility electric generators (UEGs) in the relevant service territory have been used to make the calculation required by §454.4. During electric restructuring, the Commission regulated electric utilities in Southern California Gas Company's service territory have divested themselves of their electric generation facilities. Thus, there are no more UEGs. The utility electric generation facilities have been sold to new owners who fall within a relatively new class of entities, electric wholesale generators (EWGs), which the Commission does not regulate. In D.95-12-007, the Commission determined that its regulation of EWGs would conflict with federal jurisdiction over such entities. Since UEGs no longer exist, and since the Commission does not regulate EWGs, there are no longer any generating entities that can provide the incremental heat rate data needed to compute the CGA under the formula set forth in §454.4. Although the Commission cannot through a Commission decision terminate a statute such as §454.4, it can recognize that circumstances may change in such a way as to make it impossible to implement a statute according to its express terms. Legislative action would be helpful. Even in the absence of such action, the Commission may take action designed to implement the evident intent of §454.4: to ensure that gas purchased by cogenerators at the electric generation rate be limited to the quantities used for the production of electricity. Since it is now impossible to calculate the CGA in the manner contemplated by §454.4, it is reasonable to phase out SoCalGas' outmoded CGA and to replace the CGA with a new set of safeguards designed to ensure that gas purchased at the electric generation rate is used only for the production of electricity. In order to present more clearly the Commission's position on this matter, the "Discussion" and "Findings" section of the Alternate Resolution have been revised and expanded.

7. SCUPP/IID also alleges that the draft Alternate Resolution contains factual errors. Specifically, they state that the draft alternate treats the anti-gaming provisions proposed by

SoCalGas in the 1999 BCAP as a substitute for the CGA. SCUPP/IID states:

> *In other words, the anti-gaming provisions are intended to ensure that industrial customers do not "game the system" to take unfair advantage of the proposed EG rate by installing generation facilities and then claiming the EG rate for all gas transported to their facility, regardless of whether the gas is to be used for generation or for other purposes. In contrast, the CGA is a statutory limitation on the amount of cogenerator volumes eligible for the cogeneration parity rate.*

8. We do not believe that there is any factual error in our position. We agree that the CGA limits the volume of gas eligible for the cogeneration parity rate. We believe that this volume limitation was designed to ensure that cogenerators could not purchase more gas at the cogeneration parity rate than a UEG would have needed to produce the same amount of electricity as the cogenerator, and that, if the cogenerator operated more efficiently than the UEG, the cogenerator could only purchase at the parity rate the actual volume of gas it consumed in the sequential production of electricity and steam, heat or useful work. In essence §454.4 prevents a cogenerator from "gaming" the system by purchasing more gas at the parity rate than it needs to generate electricity in combination with the production of steam, heat, or useful work. As noted earlier, absent the CGA, or an equivalent safeguard, current large users of natural gas could have the incentive to install small cogenerator units to generate a minimal amount of electricity so that they could then receive all of their gas at the reduced electric generation rate. In short, both the anti-gaming provisions in SoCalGas' 1999 BCAP and the CGA set forth in §454.4 are designed to prevent cogenerators or other industrial users from "gaming" the system to obtain more gas at the electric generation rate than they need to generate electricity. Since we will no longer be distinguishing between cogenerators who generate electricity and any other generator of electricity through our single electric generation rate schedule, it makes sense to adopt a single set of electric generation rate anti-gaming safeguards. We are not persuaded that SCUPP/IID's allegations of factual error require any changes to the Alternate Resolution.

FINDINGS

1. By Advice Letter 2709, SoCalGas requests authorization to establish a single electricity generator (EG) customer class for all of SoCalGas' service territory. In conjunction with the formation of the single EG class, SoCalGas requests that it be allowed to eliminate the Collateral Discount Rule and, by August 1, 1999, to eliminate the Cogenerator Gas Allowance.

2. On May 26, 1998, ORA filed a limited protest to A.L. 2709. ORA expresses concern over the termination date for the Cogeneration Gas Allowance. ORA recommends that the termination date of August 1, 1999 be deleted. Also on May 26th, SCUPP/IID filed a letter that partially supported and partially protested the advice letter. Like ORA, SCUPP/IID protest SoCalGas' proposal to sunset the Cogeneration Gas Allowance. SCUPP/IID protest other aspects of A.L. 2709, but in their supplemental protest on June 22, 1998, the additional protests were withdrawn.

3. The formation of a single EG customer class complies with D.98-03-073; EGs are exempt from the CARE surcharge.

4. Recent changes involving the deregulation of the electric generation market have rendered §454.4 impossible to implement on a long-term basis. There are no longer any UEGs operating in SoCalGas' service territory; therefore, there is no need for a CDR to protect cogenerators from discounts negotiated by UEGs. Regarding the CGA, the divested UEGs are now considered Exempt Wholesale Generators (EWGs). In Decision 95-12-007, Conclusion of Law No. 17 finds that the regulation of EWGs would conflict with Federal jurisdiction. Since UEGs no longer exist, and since the Commission does not regulate EWGs, there are no longer any generating "entities" that can provide the annual incremental heat rates necessary to compute the CGA. Since it is now impossible to calculate the CGA on a long-term basis using the formula set forth in §454.4, the adoption of an alternative means of carrying out the evident intent of §454.4 is appropriate.

5. SoCalGas' proposal to create a single EG class is approved.

6. SoCalGas' proposal to eliminate the Collateral Discount Rule is approved.

7. SoCalGas' proposal to eliminate the Cogenerator Gas Allowance is provisionally approved. If this Commission does not adopt a completed proposal to eliminate "gaming" by August 1, 1999 (the termination date of the CGA), the CGA will continue in effect until such safeguards are adopted and in place.

8. ORA's May 26, 1998 protest of SoCalGas' proposed termination date of the CGA is granted.

9. SCUPP/IID's June 22, 1998 supplemental protest regarding the termination date of the CGA is denied. Their request to eliminate the collateral discount is granted.

10. A "companion" resolution, G-3243, discusses the appropriateness of including divested gas-fired generators in the calculations to determine collateral discounts for cogenerators. That Resolution has been rendered moot due to the elimination of the CDR in this Resolution.

THEREFORE, IT IS ORDERED that:

1. Southern California Gas Company's request to create a single electricity generation (EG) customer class is approved. The EG class shall be exempt from the CARE surcharge.

2. SoCalGas' proposal to eliminate the Collateral Discount Rule is approved.

3. SoCalGas' proposal to eliminate the Cogenerator Gas Allowance at the end of the Global Settlement (August 1, 1999) is provisionally approved. If this Commission does not adopt a

completed proposal to eliminate "gaming" by August 1, 1999 (the termination date of the CGA), the CGA will continue in effect until such safeguards are adopted and in place.

4. ORA's May 26, 1998 protest regarding the termination date of the CGA is granted.

5. SCUPP/IID's June 22, 1998 supplemental protest regarding the termination date of the CGA is denied. Their request to eliminate the collateral discount is granted.

6. This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the state of California held on April 1, 1999, the following Commissioners voting favorably thereon:

Wesley Franklin

WESLEY M. FRANKLIN
Executive Director

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners