

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Require California Natural Gas and Electric Utilities to Preserve Interstate Pipeline Capacity to California.

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PUBLIC UTILITIES COMMISSION
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SAN FRANCISCO OFFICE
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ORDER INSTITUTING RULEMAKING TO REQUIRE CALIFORNIA NATURAL GAS AND ELECTRIC UTILITIES TO PRESERVE INTERSTATE PIPELINE CAPACITY TO CALIFORNIA

I. SUMMARY

This Order Instituting Rulemaking (OIR) is issued in response to the May 31, 2002 Federal Energy Regulatory Commission (FERC) order authorizing marketers currently serving California to turn back up to 725 million cubic feet per day (MMcf/d) of firm capacity on the El Paso Natural Gas Company (El Paso) interstate pipeline to El Paso's East of California (EOC) customers. As a result, California could permanently lose up to 725 MMcf/d of El Paso capacity unless replacement shippers acquire the turned back capacity.

Permanent loss of existing interstate pipeline capacity to California can occur as early as July 31, 2002, therefore, time is of the essence. To ensure that California retains sufficient interstate pipeline capacity to meet the needs of its natural gas and electric consumers, the Commission issues two proposed rules for comment. So that the Commission can issue its decision at the July 17, 2002 meeting, initial comments are due by July 8, 2002, reply comments are due by July 12, 2002.

The first proposed rule would require California's natural gas utilities, Southern California Gas Company (SoCalGas), Pacific Gas and Electric Company

(PG&E), San Diego Gas & Electric Company (SDG&E), and Southwest Gas Corporation (Southwest Gas), as well as California's largest electric utilities, Southern California Edison Company (Edison), PG&E, and SDG&E, to sign up for as much of this turned back capacity as possible at appropriate El Paso delivery points unless other California replacement shippers sign up for the turned back capacity. The second proposed rule states that the Commission pre-approves and finds just and reasonable the California utilities' subscription to this turned back capacity.

Each of the above-mentioned California utilities are respondents in this proceeding and are required to file comments on these proposals. All other interested parties may file comments.

Because time is of the essence, the two proposed rules need to be acted upon by July 17, 2002. In a subsequent phase of this OIR, the Commission will address other issues that relate to these proposed rules.

II. BACKGROUND

For most of the past decade, California has enjoyed the benefits of excess interstate natural gas pipeline capacity and relatively low natural gas prices at the California border, which resulted from competition among marketers of natural gas. More recently, natural gas demand in California and other states has increased and less excess interstate pipeline capacity to California has been available.

On April 4, 2000, the Commission filed a complaint with the FERC in Public Utilities Commission of the State of California v. El Paso Natural Gas Company, et al., FERC Docket No. RP00-241-000, where we challenged anticompetitive contracts between El Paso, the largest interstate pipeline serving California, and its marketing affiliate, El Paso Merchant Energy, L.P.

(Hereinafter, this will be referred to as the CPUC v. El Paso complaint proceeding.) In the CPUC v. El Paso complaint proceeding, the Commission presented evidence that El Paso and its affiliate withheld substantial amounts of interstate pipeline capacity to California, causing \$3.2 billion of excessive natural gas costs to California consumers during the 15-month term of the contracts. The issues in the CPUC v. El Paso complaint proceeding are being litigated before the FERC and will not be repeated here. It is undisputed in the CPUC v. El Paso complaint proceeding that during winter 2000/2001, El Paso only made available to California shippers approximately 2,600 MMcf/d of interstate pipeline capacity, almost 700 MMcf/d less than El Paso's certificate obligation to California of 3,290 MMcf/d. It is also undisputed that during winter 2000/2001, natural gas prices at the California border were at least two to three times higher than natural gas prices anywhere else in the nation.

One of the factors contributing to the loss of interstate pipeline capacity to California during winter 2000/2001, was the substantial growth in demand of El Paso's EOC customers and El Paso's failure to expand its system to meet all of its customers' needs. In FERC Docket No. RP00-336-002, et al., the Commission, along with numerous other parties, challenged El Paso's practice of allowing certain of its EOC customers to usurp California shippers' capacity, and sought a reasonable limit on El Paso's EOC customers' capacity rights along with a requirement that El Paso expand its system. On May 31, 2002, the FERC issued its "Order on Capacity Allocation and Complaints" (May 31 Order) and required El Paso's EOC customers to convert their capacity rights from unlimited "full requirements" to a limited Contract Demand (CD) amount of firm capacity. See El Paso Natural Gas Company, et al., 99 FERC ¶ 61,244 (2002).

FERC's May 31 Order requires El Paso's EOC customers to decide by July 31, 2002 how much El Paso capacity rights they will need in CD contracts in the near future. The FERC also found that marketers currently serving California under CD contracts are willing to turn back between 592 MMcf/d and 725 MMcf/d of firm capacity to EOC customers to meet new EOC CD demands (in addition to EOC customer's use of El Paso's expansion of its facilities). Although the Commission filed comments in the FERC proceeding arguing that any turned back capacity by marketers currently serving California should first be offered to willing replacement shippers serving California, the FERC's May 31 Order does not address the Commission's proposal. Whether the FERC subsequently clarifies that the turned back capacity should first be offered to California replacement shippers, or the issue is resolved in negotiations with marketers or settlement meetings contemplated in a "capacity rationalization process" provided for in the FERC May 31 Order, if no California replacement shipper comes forward to acquire the turned back capacity, California could permanently lose up to 725 MMcf/d of firm capacity on the El Paso system. As California experienced during the winter of 2000/2001, the loss of this significant amount of El Paso capacity could have devastating rate impacts on California consumers. It is therefore imperative that California replacement shippers subscribe to this capacity and that EOC customers' needs be met by El Paso system expansions rather than by transferring turned back California capacity to the EOC customers.

Marketers who plan to turn back California capacity on the El Paso system have no public service obligation to meet the needs of California consumers. Their willingness to turn back California capacity on the El Paso system is instead driven by profits and losses, including any potential short term financial

losses without regard to potential long term profits. On the other hand, our Commission and the California utilities are responsible for ensuring that California consumers' natural gas and electric needs are met without risk of the substantial spike in natural gas prices and electric prices that occurred during winter 2000/2001.¹ Consequently, we must ensure that California preserves as much as possible of the 3,290 MMcf/d of certificated firm capacity on El Paso to California.

III. PROPOSED RULES REQUIRING SUBSCRIPTION TO TURNED BACK CAPACITY

Under the FERC's May 31 Order, the turn back of up to 725 MMcf/d of capacity will occur as early as July 31, 2002, and, therefore, time is of the essence. If we require California utilities to sign up as replacement shippers, they must be able to do so by July 31, 2002 or risk forever losing a significant portion of El Paso's capacity to California, with adverse consequences to California natural gas consumers, both in terms of extremely high prices and shortages of natural gas. Moreover, because natural gas-fired powered plants provide a substantial amount of electricity in California, the potential loss of access to natural gas could cause significant adverse impacts to the California electric consumers both in terms of extremely high prices and potential blackouts due to lack of fuel. In light of the deadlines imposed by the FERC in its May 31 Order, the Commission must pursue expeditious comments on proposed rules in order to prevent potentially dire consequences to California natural gas and electric consumers.

¹¹ The Commission has ample authority to ensure that California utilities provide adequate and reliable service at just and reasonable rates. See California Constitution, Article XII, Section 6; California Public Utilities Code Sections 451, 701, and 761.

In light of the need for timely action, we limit our initial request for comments to the following two issues. All comments by respondents and other interested parties should be limited to these two fundamental issues.² The first proposed rule is that California's natural gas utilities, SoCalGas, PG&E, SDG&E, Southwest Gas, and California's largest electric utilities, Edison, PG&E, and SDG&E, each be required to sign up for a proportionate amount of the turned back capacity not subscribed to by replacement shippers serving California. The second proposed rule is that the Commission find just and reasonable and pre-approve the California utilities subscription to the turned back capacity. The second rule would guarantee that utility compliance with the Commission's requirement cannot be the basis for a finding of unreasonableness in signing up for the turned back El Paso capacity. All other related issues, such as the allocation among the California utilities' customers for the recovery of these costs or any reasonable or necessary adjustments to a utility company's core procurement incentive mechanism, will be addressed in a later phase in this case. We further describe the two proposed rules, and the issues to be considered, below.

The first proposal, for which the Commission seeks comments, is the requirement that California utilities sign up for as much turned back capacity as possible (that other California replacement shippers do not sign up for and California would otherwise risk losing on the El Paso system). The Commission cannot at this time identify a definitive amount that each California utility should sign up for because the FERC order only indicates a willingness on the part of the

² The proposed rules are attached to this OIR as Appendix A. Various specialized terms are also defined therein.

marketers to turn back up to 725 MMcf/d of firm capacity on El Paso to California. California marketers may ultimately decide to turn back much less of this capacity. Therefore, we are dealing with a moving target and cannot know at this time the exact amount of capacity that marketers will ultimately choose to turn back or the amount of turned back capacity at particular delivery points on El Paso.³ Likewise, we do not know at this time whether other California replacement shippers (i.e., marketers or end-users in California) intend to sign up for any of the turned back capacity. For example, the City of Long Beach, California or an industrial customer in California may choose to sign up for El Paso capacity rights and purchase natural gas in the Southwest producing basins rather than at the California border.

By proposing that each large California utility subscribe to a proportionate amount of the turned back El Paso capacity, it will spread the El Paso reservation charges (associated with this turned back capacity) over a larger base of ratepayers so that the burden will not fall on any one set of ratepayers and will be minimal to any particular ratepayer. In return, California will have sufficient interstate pipeline capacity in the near future, to help prevent natural gas shortages, electric power shortages and unreasonably high natural gas and electric prices resulting therefrom.

For example, the Commission contemplates that some of the California natural gas utilities, who currently do not have capacity rights on El Paso, may

³ The proposed rule requires the utilities to sign up for turned back capacity at El Paso delivery points that can transport natural gas to the utilities, such as Southern California delivery points for SoCalGas, SDG&E, Edison, and Southwest Gas and the PG&E-Topock delivery point for PG&E. The Commission is not requiring any utility to sign up for turned back capacity solely at the Mojave-Topock delivery point.

use the newly acquired El Paso capacity to meet their core customer needs. Undoubtedly, it is also necessary to preserve capacity to meet the noncore customers' needs in California, including the needs of electric generation power plants or Qualifying Facilities. Therefore, the California natural gas utilities, including SoCalGas, and the California electric utilities should also sign up for additional El Paso capacity turned back by the marketers, in order to preserve additional capacity for noncore gas customers' needs. To the extent that they do not need the capacity for their own needs, the California utilities can recover the cost of this capacity by short-term capacity releases in the secondary market and through a surcharge on their intrastate rates to make up the difference between costs and revenues for this capacity.

In proposing this rule, the Commission contemplates that the California utilities will negotiate directly with marketers wishing to turn back capacity (i.e., obtain a permanent or long-term capacity release from the marketer at or below the maximum transportation rate) or as part of the formal "capacity rationalization process" contemplated by the FERC's May 31 Order. The Commission does not intend to limit in any way the El Paso EOC customers' growth and legitimate needs for capacity in their own right. We expect El Paso will expand its system sufficiently to meet all of its customers' needs, rather than pit one class of customers against another class of customers as it has done in the past.

The second proposal is to pre-approve and find just and reasonable the practice and costs of each of the California utilities in signing up for a proportionate amount of the El Paso turned back California capacity. In light of previous Commission decisions during very different market conditions (i.e., significant excess pipeline capacity to California), California utilities may be

reluctant to sign up for turned back capacity on the El Paso system. As discussed, there is much less excess pipeline capacity to California than there previously had been, and our experience during winter 2000/2001, when California was deprived of substantial amount of interstate pipeline capacity, has demonstrated the severe adverse effects that can occur when there is insufficient interstate pipeline capacity to meet California's needs. Thus, the Commission proposes finding that it is just and reasonable for the California utilities to sign up for the turned back capacity without risking that their subscription to this turned back capacity would ever be used as a ground for disallowing any portion of these costs in rates.

To ensure that shippers serving California have sufficient capacity to meet California's needs during peak times (i.e., winter and summer months), the Commission proposes requiring the California utilities to sign up for the El Paso system turned back capacity not subscribed to by other shippers serving California. California's natural gas utilities, SoCalGas, PG&E, SDG&E, and Southwest Gas, as well as California's largest electric utilities, Edison, PG&E, and SDG&E would be subject to this requirement.

California utilities identified herein are named respondents in this proceeding and are required to file comments on these proposals. All other interested parties may file comments.

IV. PRELIMINARY SCOPING MEMO

Rule 6(c)(2) of our Rules of Practice and Procedure⁴ provides that an OIR "shall preliminarily determine the category and need for hearing, and shall

⁴ Title 20 California Code of Regulations.

attach a preliminary scoping memo.” This OIR is preliminarily determined to be quasi-legislative, as that term is defined in Rule 5(d). It is contemplated that this proceeding will be conducted through a written record, with no evidentiary hearing for this phase, and that an order will issue based on the comments timely filed in this docket.

The scope of this initial phase of the OIR is to adopt rules by which the designated utilities are each required to sign up for a proportionate amount of turned back capacity that is not subscribed to by other replacement shippers serving California. As a corollary to this proposal, the Commission finds just and reasonable and pre-approves the California utilities subscribing to this turned back capacity. All other related issues, such as the allocation among the California utilities’ customers for the recovery of these costs, or any necessary adjustments to a utility company’s core procurement incentive mechanism, will be addressed in a later phase of this proceeding.

Interested parties are invited to file comments to these proposals. In addition to commenting on these two proposals, parties filing comments shall include in their comments any objections they may have regarding the categorization of this proceeding as quasi-legislative, as well as whether there are any objections to this preliminary scoping memo, or to the expedited schedule set forth herein.

Comments shall conform to the requirements of Rule 14.5 and opening comments shall be filed with the Commission’s Docket Office and served no later than July 8, 2002. Reply comments are limited to ten pages and are due July 12, 2002.

In accordance with Rule 6.3 and 6(c)(2) we provide a preliminary schedule for Phase I. Phase II scheduling will be addressed in a subsequent ruling.

V. PHASE I SCHEDULE

We adopt the following preliminary schedule:

OIR issued	June 27, 2002
Comments filed	July 8, 2002
Reply comments filed	July 12, 2002
Decision issued	July 17, 2002

The FERC order was issued May 31, 2002, and the first opportunity to issue this OIR is June 27, 2002. The next scheduled Commission meeting prior to July 31, 2002 is July 17, 2002, and the short time between these two meetings does not allow time for comments on a proposed decision. We state here our intent to waive the 30-day review and comment provided for in Pub. Util. Code § 311(g)(1) and to issue a decision consistent with § 311(g)(3).

VI. EX PARTE COMMUNICATIONS

This proceeding is subject to Rule 7, which specifies standards for engaging in ex parte communications and the reporting of such communications. Because we have preliminarily categorized this proceeding as quasi-legislative, pursuant to Rules 7(a)(4) and 7(d), ex parte communications will be allowed without any restrictions or reporting requirements until the assigned Commissioner makes an appealable determination of category as provided for in Rules 6(c)(2) and 6.4. Following the Commissioner's determination, the applicable ex parte communication and reporting requirements shall depend on such determination unless and until the determination is modified by the Commission pursuant to Rule 6.4 or 6.5.

VII. SERVICE LIST

The service list from R. 01-01-001 shall be the initial service list for this proceeding. The service list shall be posted on the Commission's web site, www.cpuc.ca.gov, as soon as practicable. Choose "Service Lists" on the "Quick Links" bar. The service list for this proceeding can be located in the "Index of Service Lists" by scrolling to the proceeding number. To view and copy the electronic addresses for a service list, download the comma-delimited file, and copy the column containing the electronic addresses. The Commission's Process Office periodically updates service lists to correct errors or to make changes at the requests of parties and non-parties on the list.

Any party interested in participating in this OIR who is unfamiliar with the Commission's procedures should contact the Public Advisor's Office in Los Angeles (213) 649-4782, public.advisor.la@cpuc.ca.gov, or in San Francisco (415) 703-2074, public.advisor@cpuc.ca.gov.

VIII. SERVICE BY ELECTRONIC MAIL

Because of the expedited schedule in this proceeding, service of the comments is to be made by electronic means to all parties providing the Commission with an electronic mail address. The assigned Administrative Law Judge and Commissioner are to be served electronically at cab@cpuc.ca.gov and lyn@cpuc.ca.gov. Service by electronic mail will be used in lieu of paper mail where an electronic address has been provided. Any party on the service list who has not provided an electronic mail address shall serve and take service by way of paper mail. Service by mail is described in Rule 2.3(a).

Therefore, **IT IS ORDERED** that:

1. A rulemaking is initiated on the Commission's own motion to issue proposed rules to require California's natural gas utilities and largest electric

utilities to sign up for turned back capacity at appropriate El Paso delivery points and to pre-approve and find just and reasonable the California utilities' subscription to this turned back capacity.

2. California's natural gas utilities, Southern California Gas Company (SoCalGas), Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Southwest Gas Corporation (Southwest Gas), as well as California's largest electric utilities, Southern California Edison (Edison), PG&E, and SDG&E are made respondents to this proceeding.

3. The Executive Director shall cause this Order Instituting Rulemaking (OIR) to be served on respondents and on the service list for Rulemaking (R.) 01-01-001.

4. An initial service list for this proceeding shall be created by the Process Office and posted on the Commission's website (www.cpuc.ca.gov) as soon as it is practicable.

5. The category of this rulemaking is preliminarily determined to be "quasi-legislative" as that term is defined in Rule 5(d) of the Commission's Rules of Practice and Procedure.

6. Respondents shall, and interested parties may, submit comments on the issues identified in this OIR and the rules proposed in Appendix A by July 8, 2002, and reply comments, limited to ten pages, by July 12, 2002.

7. Pursuant to Commission Rules of Practice and Procedure, Rule 6 (c)(2), parties shall include with their opening comments any objections they may have regarding the categorization of this OIR or the procedural schedule.

This order is effective today.

Dated June 27, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE

R.02-06-041 ALJ/CAB/eap *

CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

APPENDIX A
PROPOSED RULES

A. Definitions

1. “El Paso” as used herein means the El Paso Natural Gas Company interstate natural gas pipeline
2. “El Paso’s Southern California delivery points” as used herein means El Paso’s delivery points interconnecting with Southern California Gas Company’s intrastate system at Topock or Ehrenberg.
3. “El Paso’s PG&E-Topock delivery point” as used herein means El Paso’s delivery point interconnecting with Pacific Gas and Electric Company’s intrastate system at Topock.
4. “Turned back capacity” as used herein means the up to 725 MMcf/d of El Paso firm capacity right, currently held by shippers serving California that marketers decide to turn back to El Paso based upon the Federal Energy Regulatory Commission’s (“FERC”) May 31, 2002 order. See El Paso Natural Gas Company, et. al., 99 FERC ¶ 61,244 (2002).
5. “California replacement shippers” as used herein means any shippers (e.g., marketers or California end-users) willing to sign up for the turned back capacity and continue to use that capacity to transport natural gas to California.
6. “Proportionate amounts” as used herein means the Southern California utilities’ fair share of the turned back capacity, taking into account their historic use of natural gas and El Paso capacity on behalf of all of their customers.

B. Subscription to Turned Back Capacity

1. Southern California Gas Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southwest Gas Corporation shall sign up in proportionate amounts for as much El Paso turned back capacity as possible at El Paso’s Southern California delivery points to the extent that California replacement shippers do not sign up for the turned back capacity.
2. Pacific Gas and Electric Company shall sign up for as much El Paso turned back capacity as possible at El Paso’s PG&E-Topock

delivery point to the extent that other California replacement shippers do not sign up for the turned back capacity.

3. After the above-mentioned California utilities sign up for the turned back capacity, they shall use this capacity for their own needs or offer this capacity in the short-term capacity release market to California replacement shippers. These utilities shall also file a report with Energy Division stating the amount of turned back capacity (and at which delivery points) to which they subscribed.

C. Pre-approval of subscription

The California utilities' compliance with the above-mentioned rule (i.e., B. Subscription to Turned Back Capacity) is pre-approved by the Commission and found to be just and reasonable.

(END OF APPENDIX A)