BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Rules to Ensure Reliable, Long-Term Supplies of Natural Gas to California	R.04-01-025 (Phase I)

RATEPAYERS FOR CLEAN AFFORDABLE ENERGY COALITION'S APPEAL OF QUASI-LEGISLATIVE CATEGORIZATION

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RATEPAYERS FOR AFFORDABLE CLEAN ENERGY

Dated: June 28, 2004

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RACE COALITION APPEAL OF QUASI-LEGISLATIVE CATEGORIZATION

Pursuant to Rule 6.4 of the Commission's Rules of Practice and Procedure, Ratepayers for Affordable Clean Energy (RACE) Coalition appeals the assigned commissioners' determination in the June 18, 2004 Ruling that categorizes Phase I of R.04-01-025 as quasi-legislative.[1] The relevant passage from June 18, 2004 Ruling states:

> *Pursuant to Rule 6(c)(2) of the Commission's Rules of Practice and Procedure, the OIR preliminarily determined that the category of this proceeding to be quasi-legislative. Some of the parties requested in their responses to the Phase I proposals that evidentiary hearings be held on several issues, and that those hearings be categorized as ratesetting. As discussed above in the scope of issues, the Phase I decision will determine what policy issues should be addressed immediately and what other issues may require separate proceedings or be handled at a later date in this proceeding. This scoping memo and ruling confirms that the issues raised by the respondents and the other parties should be categorized as quasi-legislative. Anyone who disagrees with this categorization must file an appeal of the categorization no later than ten days after the date of this ruling. (See Rule 6.4.)*

Ratesetting and quasi-legislative categories are defined by Rule 5 as follows:

> *5(c) "Ratesetting" proceedings are proceedings in which the Commission sets or investigates rates for a specifically named utility (or utilities), or establishes a mechanism that in turn sets the rates for a specifically named utility (or utilities). "Ratesetting" proceedings include complaints that challenge the reasonableness of rates or charges, past, present, or future.*
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> *5(d) "Quasi-legislative" proceedings are proceedings that establish policy or rules (including generic ratemaking policy or rules) affecting a class of regulated entities, including those proceedings in which the Commission investigates rates or practices for an entire regulated industry or class of entities within the industry.*

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[1] It should be noted that the RACE Coalition now includes Environment California.

RACE incorporates by reference the previously submitted briefs and evidence in this rulemaking from March 9 and March 23. For the following reasons, Phase I of Proceeding R.04-01-025 should be categorized as ratesetting.

I. MATERIAL ISSUES OF DISPUTED FACT REMAIN REGARDING THE FORECASTED DEMAND FOR NATURAL GAS IN CALIFORNIA; THIS DISCREPANCY CAN ONLY BE RECONCILED THROUGH EVIDENTIARY HEARINGS

The Phase I Proposals include the following three issues: (1) the California public utilities' decisions concerning their existing interstate pipeline capacity; (2) access on the intrastate pipelines to LNG supply in the future; and (3) additional access to or expansion of interconnecting facilities with interstate pipelines to increase California's access to natural gas supplies. These determinations must necessarily be based on how much gas California needs and will have a direct impact on the rates and the ratesetting process, including determining who will bear the costs of interconnection and system expansion costs. However, the factual dispute over this material threshold question of forecasted demand has not yet been resolved.

As of last August, the CEC forecasted gas demand growth of 1.5 percent per year through 2013[2]. However, the utilities forecasted virtually no demand growth for that period.[3] Meanwhile the CPUC, CEC, and California Power Authority (CPA) jointly adopted an Energy Action Plan (EAP) in May 2003 that provides a roadmap for dramatic reductions in gas demand during this time period.[4] This has been briefed in previous submissions to the Commission.[5] The extent to which gas demand increases in the latter part of the decade and beyond will be to a large degree driven by decisions at the CPUC and state legislation.

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[2] *Natural Gas Market Assessment*, CEC Staff Paper, August 2003, page 14.
[3] PGE and SoCalGas/SDGE forecasts, CPUC/CEC Natural Gas Demand Workshop, 2006-2016, December 9-10, 2003.
[4] CPUC/CEC/CPA, *Energy Action Plan*, May 2003.
[5] Energy conservation is identified by the CPA as more cost-effective than combined-cycle baseload power. See Table 1. The CEC staff recommend an energy conservation target of 12,000 Gwh reduction in electricity use by 2008 and a 30,000 Gwh reduction by 2013.[5] The energy conservation programs generating these reductions would be funded by public good charges and supplemental procurement decisions. The 12,000 Gwh target is equivalent to approximately 330 million cubic feet a day (mmcfd) of gas,[5] roughly one-half the throughput capacity of an LNG terminal. This reduction in gas demand would occur <u>before</u> any currently proposed LNG terminal would be online. The 30,000 Gwh reduction target be 2013 is equivalent to slightly more than the 800 mmcfd design throughput of one LNG terminal.

The CPUC's Phase I decision will use the demand projections to determine how much and what kinds of gas investment to allow. This would affect rates by locking ratepayers into long-term LNG contracts or pipeline investments for the added new capacity. Whether the utilities are seeking pipelines or contracts, both would affect rates.

Moreover, it is generally agreed that the added capacity would not be for the benefit of core gas customers, but rather would be consumed by new gas-fired power plants to serve electricity customers. Thus far, no party has established that this new capacity would be consumed by gas customers; only that somehow the increased capacity may serve to lower spot market prices overall. Core gas and electric customers, however, would not be able to benefit from the spot-market.

A public evidentiary process is necessary to test these underlying facts, assumptions and impacts. Given the discrepancy in the forecasted demand, which is further complicated by the Community Choice cities' plans to exit the public utility system and the measures proposed in the EAP and IEPR, the CPUC cannot establish a sound mechanism or process for the pre-approval of long-term contracts. Accurate projections for a limited number of scenarios are necessary in order for the Commission to make an informed decision on whether and what new sources of natural gas supply are necessary. Since these determinations will impact rates for both gas and electricity generation, the entire matter should be categorized as a ratesetting proceeding.

II. THE COSTS AND BENEFITS OF RATEBASING LNG CONTRACTS AND CONNECTION FACILITIES ARE DISPUTED AND THE COMMISSION MUST UNDERSTAND THE IMPACT ON RATES PRIOR TO MAKING A DETERMINATION

The incorporation of LNG into California's energy portfolio would impact customer rates if the LNG-related contracts and upgrades are ratebased. An open evidentiary process in Phase I of Proceeding R.04-01-025 could serve as the de facto "*Evaluation of the net benefits of increasing the* *state's natural gas supply options, such as liquefied natural gas*" called for in California's Energy Action Plan, Action 6.

The OIR and the June 17, 2004 Ruling appear to presume that LNG must be a part of the utilities' diversity of supply. This presumption is premature as it precedes any rigorous analysis performed to date by the relevant state agencies, specifically the CPUC and the CEC.

The CEC's December 2003 *Integrated Energy Policy Report* indicates that California's in-state gas producers supply approximately 15 percent of the state's needs and could increase this percentage if various economic and regulatory disincentives are removed (pg. 27). Fifteen percent of California's current demand is approximately 1,000 mmcfd, about the equivalent output of one LNG terminal. The CEC then clarifies that it has been unsuccessful (via the Natural Gas Working Group) in brokering a solution between California producers and PGE and SoCalGas (pg. 28) that would allow increased gas deliveries. It would appear that potentially hundreds of mmcfd of additional instate gas supplies are unavailable because of what may amount to little more than bureaucratic turf battles. It would also appear that prompt resolution of these dispute(s) would have a direct and positive impact on rates, and put downward pressure on the need to develop new sources of natural gas supply. Resolution of the dispute(s) would also result in an increase in supply almost immediately, very close to the point of demand, as opposed to the four-year lag between financing an LNG project and initial operation. Moreover, the Energy Action Plan's ("EAP") Action 6 calls for the state to make this analysis a priority and to "*Evaluate the net benefits of increasing the state's natural gas supply options, such as liquefied natural gas.*" Thus far, however, there has been no formal evaluation of the net benefits of LNG, or the potential negatives, by either the CEC or the CPUC since the adoption of the EAP in May 2003.

The CEC's December 2003 *Integrated Energy Policy Report* (IEPR) includes only the following short reference (at p.28):

> *"There are growing concerns that natural gas production from existing basins is in decline and unable to keep pace with growing demand for natural gas in North America. Many public and private natural gas analysts now predict that North American gas production will decline in future years. It is also unclear whether the industry can provide enough infrastructure to find and extract new sources of supply as well as add enough pipeline capacity to match current and future natural gas demand. Therefore, there is considerable interest in further developing infrastructure for liquefied natural gas (LNG) in North America to supplement our current supply of natural gas.*
>
> *The completion of one or more of the currently proposed LNG facilities on the West Coast could add in excess of 1 Bcf per day of additional supplies. More importantly, LNG provides an opportunity for California to access supply from other countries and continents that may help bring downward pressure on Canadian and U.S. gas prices. However, overdependence on a foreign supply has to be an additional concern."*

These two paragraphs do not qualify as an assessment of the net benefits and/or concerns of increasing the state's natural gas supply options via LNG. Especially given the lack of corroborated information and the CEC's warning regarding overdependence on a foreign supply, a rigorous evaluation is absolutely necessary before proceeding further. The core of the query is whether vigorous pursuit of the first five EAP priorities delay or obviate the need to pursue new sources of natural gas supply. This fundamental question has not even been asked, much less evaluated.

Nor would LNG's potential to lower local spot market prices necessarily benefit ratepayers, and they would be locked into long-term gas contracts. Ratebasing LNG contracts will mean core customers pay higher rates while non-core customers reap the spot market benefits of a more abundant supply of gas. Therefore, the presumption that LNG contracts will automatically benefit ratepayers is in dispute.

In addition to calling for an assessment of increasing the state's natural gas supply options, EAP Action 6 also calls for the state to: "*Monitor the gas market to identify any exercise of market power and manipulation, and work to improve FERC-established market rules to correct any observed abuses*." This points to concerns that dependence on natural gas make California more vulnerable to

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[6] May 21, 2004 Sempra letter to Greenpeace.

market power and manipulation, which is related to FERC's inability or unwillingness to establish market rules to correct abuses. FERC actions clearly indicate California has very little leverage with the agency, as the Attorney General Lockear's recent white paper on natural gas makes clear. A commonsense alternative would be to put continuous downward pressure on natural gas prices by vigorous implementation of EAP Actions 1-5. Table 2 provides a summary snapshot of the benefits of vigorous implementation of EAP Actions 1-5.

Finally, the determinations made in this proceeding would affect the measure of California's dependence on gas for electricity generation, possibly allowing it to rise to such an extent that ratepayers are harmed by overdependence. The 2003 Integrated Energy Policy Report states that (at pg. 26) "*. . . natural gas-fired generation in California is expected to increase from 36 percent in 2004 to 43 percent in 2013. The reductions in available hydroelectricity will push this percentage even higher.*" To appellant's knowledge, thus far there has been no evaluation of whether increasing California's dependence on natural gas to 43 percent or beyond is in the best interests of California utility ratepayers.

As shown above, the potential benefits and costs of LNG to California ratepayers, and the impact its importation might have on rates, has not been adequately evaluated in order for the Commissioners to make a sound and informed decision on the matters in Phase I.

III. Ratebasing LNG Connection Facilities Will Result in Extra Costs to Core Gas Customers.

The proposed LNG plans would lock core customers into new costs. In the case of Sempra's LNG project in Baja California, the company is attempting to have utilities owned by Sempra (SoCalGas and SDGE) ratebase and roll-in to existing customers' rates up to S200 million in pipeline upgrades to facilitate transport of gas from the LNG terminal. At the same time, Sempra states that half the output from the LNG terminal will go to Baja California at the expected startup in 2007, and all will go to Baja California by 2015.[9] The prudence of ratebasing and rolling in to existing customer's rates $200 million in pipeline upgrades to facilitate gas flow from Baja California to California, for a limited and rapidly declining volume of gas available for only a few years, is very much in dispute. What is clear, however, is that this would impact SoCalGas and SDG&E rates. Therefore, the Commissioners' ruling in this matter will have a direct impact on the rates of core customers in the SoCalGas and SDGE service territories.

Meanwhile, the two California LNG terminal proposals include no request to ratebase modifications to utility pipeline infrastructure to accommodate the new supply. These upgrades would be paid for by the private developer. One of the developers has explicitly represented that it will not seek to ratebase any LNG supply. Leaving issues of safety and need to the side for the moment, this would appear to be one scenario where core customers would benefit from the greater abundance of gas driving down prices on the spot market. In contrast, authorizing the utilities to ratebase and roll-in the costs of LNG interconnection facilities would have the opposite effect, with ratepayers stuck with higher fixed long-term contract rates while non-core customers benefit from the spot market prices.

IV. CONCLUSION

As stated above, all aspects of the Phase I of R.04-01-025 will impact rates and therefore the proceeding should be categorized as a ratesetting proceeding.

Respectfully submitted,

Dated: June 28, 2004

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Table 1. Cost of Energy Options for California

Energy Options[a] and 2004 Residential Power Rates	$/kwh[b]
Natural gas combined-cycle power plant (baseload)	0.052
Natural gas simple cycle power plant (peaking)	0.157
Wind	0.049
Solar thermal (parabolic trough)	0.14 – 0.17
Geothermal (flash)	0.045
Energy conservation measures[c]	0.03 – 0.06
San Diego Gas & Electric 2004 residential charge	0.15[d]
CFE, North Baja California 2004 residential charge	0.22[e]

Note (a): California Energy Commission, *Comparative Cost of California Central Station Electricity Generation Technologies*, August 2003, pg. 3 and 11.
Note (b): "levelized direct cost" – assumes life-of-project natural gas cost in $5/MMBtu to $6/MMBtu range.
Note (c): California Consumer Power and Conservation Financing Authority, "*Clean Growth: Clean Energy for California's Economic Future – Energy Resource Investment Plan*," February 2002, Table 6-2, pg. 54.
Note (d): Includes only metered kwh usage charge and "electric energy charge," April 2004.
Note (e): Includes only December 2003 published CFE summer usage charge based on 1,000 kwh/month usage.

Table 2. California Natural Gas Use, Project Need, Options for Meeting Need

Gas Demand, Projected Demand Increase by California Natural Gas Utilities, Supply/Demand Reduction Options	Gas Quantity, mmcfd (million cubic feet per day)
Average daily natural gas use in California, 2001	6,600
Projected increase in gas demand over 2002 baseline, 2006-2016	0-200[a]
Average projected daily natural gas delivery from one LNG terminal	700-800
Reduction in California gas demand from conservation measures and renewable energy supplies identified as cost-effective priorities by state	1,100 – 1,500[b]

Note (a): Derived from presentations by PGE, SoCalGas, and SDGE at CEC/CPUC Natural Gas Workshop, Dec. 9-10, 2003. 2006-2016 demand increase in SoCalGas/SDGE territory: 0 mmcfd. In PGE territory: 0-200 mmcfd.
Note (b): Derived from Synapse Energy Economics evaluation submitted in March 23, 2004 RACE coalition comments in CPUC Utility Long-Term Natural Gas Procurement Proceeding, Rulemaking 04-01-25

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the RATEPAYERS FOR AFFORDABLE CLEAN ENERGY COALITION APPEAL OF QUASI-LEGISLATIVE CATEGORIZATION on the service list for R.04-01-025 by serving a copy to each party by electronic mail, or by mailing a properly addressed copy by first-class mail with postage prepaid to each party unable to accept service by electronic mail.

Executed on June 28, 2004, at Oakland, California.

/s/ Paul Fenn

Paul Fenn