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Exhibit Number : DRA-01
Commissioner : Simon
ALJ : Sullivan
Witness : Peck



**DIVISION OF RATEPAYER ADVOCATES
CALIFORNIA PUBLIC UTILITIES COMMISSION**

**DRA Report on the
Application of Southern California Gas Company to
Establish a Compression Services Tariff**

San Francisco, California
May 16, 2012

TABLE OF CONTENTS

1

2 **CHAPTER 1 INTRODUCTION AND BACKGROUND..... 1**

3 **CHAPTER 2 SUMMARY OF DRA FINDINGS AND**

4 **RECOMMENDATIONS 4**

5 **CHAPTER 3 DISCUSSION 5**

6 **A) A.11-11-011 IS NOT CONSISTENT WITH PRIOR COMMISSION**

7 **DECISIONS REGARDING UTILITY INVOLVEMENT IN THE MARKET**

8 **FOR NATURAL GAS VEHICLES (NGVs)..... 5**

9 **B) SoCALGAS’ REPRESENTATION OF PUBLIC UTILITIES CODE 740.3 IS**

10 **INCOMPLETE..... 8**

11 **C) SoCALGAS’ PROPOSED TARIFF IS ANTI-COMPETITIVE AS**

12 **SoCALGAS WILL ENJOY SEVERAL MARKET ADVANTAGES BASED**

13 **ON ITS MONOPOLY STATUS..... 8**

14 **D) SoCALGAS DOES NOT PROVIDE A SUFFICIENT LEVEL OF DETAIL**

15 **TO DETERMINE WHETHER THE TARIFF WOULD COVER THE FULLY**

16 **LOADED COSTS OF THE SERVICE 9**

17 **E) THE COMMISSION SHOULD ANALYZE THE PROCESS AND COST**

18 **ESTIMATES USED BY SoCALGAS TO ESTIMATE THE TARIFF FOR AL**

19 **4337 10**

20 **F) THERE ARE NO SUBSTANTIAL, TANGIBLE RATEPAYER BENEFITS**

21 **ASSOCIATED WITH THE APPLICATION YET RATEPAYERS TAKE ON**

22 **ALL OF THE DOWNSIDE RISK OF THE APPLICATION 11**

23 **G) SoCALGAS SHAREHOLDERS ACCRUE ALL OF THE FINANCIAL**

24 **BENEFITS OF THE APPLICATION BUT TAKE ON VERY LITTLE RISK... 14**

25

1 **CHAPTER 1 INTRODUCTION AND BACKGROUND**

2 This Exhibit presents the analysis and recommendations of the Division of Ratepayer
3 Advocates (DRA) on Application (A.) 11-11-011 that Southern California Gas Company
4 (SoCalGas) filed on November 3, 2011 proposing a new compression services tariff to serve
5 non-residential customers requiring natural gas compression above standard line pressure for
6 customer end-use applications.

7 DRA developed this analysis and recommendations pursuant to the Ruling and
8 Scoping Memo of the Assigned Commissioner issued on February 22, 2012. The Ruling and
9 Scoping Memo directed parties to serve testimony on the SoCalGas Application in terms of
10 policy and associated ratemaking.

11 As stated in Application A.11-11-011, SoCalGas proposes to build, own, and operate
12 gas compressors and related equipment on the customer’s site to provide compressed gas, but
13 will not conduct operations beyond the service delivery point. Some of the customer end-use
14 applications are for Natural Gas Vehicle (NGV) refueling operations, Combined Heat and
15 Power (CHP) facilities, and peaking power plants.¹

16 According to SoCalGas, it intends to provide this proposed service in response to
17 customer demand, to promote the environmental benefits of using natural gas, and to create
18 new opportunities for new and existing service providers. SoCalGas sees a net benefit to the
19 ratepayers by providing this tariff service.² SoCalGas believes that it has structured the
20 pricing basis that includes all associated costs and overheads with no tie to monopoly utility
21 services.³ SoCalGas claims that there are no downside risks to ratepayers, and to the extent

¹ Though SoCalGas states that A.11-11-011 could have multiple end-use applications (i.e., NGV refueling operations, CHP facilities, and peaking power plants), the focus of DRA’s testimony is primarily on NGV refueling operations as SoCalGas presents this specific end-use application as the most prevalent opportunity for A.11-11-011 and is the focus of SoCalGas Advice Letter 4337 and because the Commission has stated strong policy preferences in regards to utility involvement in NGV refueling options.

² Lines 13 to 16, Page 1, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

³ Lines 14 to 17, Page 14, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

1 that resources embedded in general rates are used to support the proposed tariff service, the
2 costs will be reimbursed to ratepayers.⁴

3 SoCalGas has not requested funding for the Compression Services Tariff activities in
4 the general rate case (GRC) A.10-12-006 currently before the Commission. Neither the
5 authorized base margin nor general base rates in the current GRC will include Compression
6 Services Tariff costs.⁵ The two cost components of the Compression Services Tariff,
7 Ownership Charge and O&M Charge, include costs for using SoCalGas' existing resources
8 (i.e., embedded costs) that are currently in the authorized base margin. SoCalGas plans to
9 use the revenues credited to the appropriate balancing accounts to offset those embedded
10 costs in the subsequent GRC.⁶

11 SoCalGas claims that it currently has the authority based on the Special Facilities
12 provision of the current tariff Rule 2 to provide natural gas at non-standard pressures to
13 customers.⁷ SoCalGas states that historically, the Special Facilities provision has applied
14 only for the installation of permanent facilities of fifty years or more of useful life.⁸
15 However, SoCalGas clarified during a teleconference with the Division of Ratepayer
16 Advocates (DRA) that it has never utilized this special Rule 2 provision to install a natural
17 gas compression facility.⁹

18 SoCalGas also claims that General Order (GO) 96-B provides it authority to install
19 natural gas compression facilities for government entities.¹⁰ It filed Advice Letter (AL) 4337

⁴ Lines 13 to 15, Page 23, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

⁵ Lines 3 to 8, Page 9, Chapter III, Prepared Direct Testimony of Edward J. Reyes, A.11-11-011, November 3, 2011.

⁶ Lines 8 to 11, Page 11, and Lines 17 to 21, Page 12, Chapter III, Prepared Direct Testimony of Edward J. Reyes, A.11-11-011, November 3, 2011.

⁷ Lines 17 to 19, Page 2, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

⁸ Lines 12 to 13, Page 3, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

⁹ Teleconference between DRA and SoCalGas, April 27, 2012.

¹⁰ Line 19, Page 2 to Line 2, Page 3, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

1 on February 28, 2012 proposing a natural gas compression services agreement with Los
2 Angeles Unified School District (LAUSD). DRA, Clean Energy, and Integrys filed protests
3 to the AL. DRA pointed out in its protest that SoCalGas had filed this instant Application
4 for permission to create a new tariff for broad authority for natural gas compression
5 services. The tariff SoCalGas seeks in this application would provide service for non-
6 residential customers requiring natural gas compression above standard line pressure for
7 customers such as LAUSD. DRA recommended the suspension of the AL until all the
8 relevant issues are resolved during the A.11-11-011 proceeding. The Energy Division
9 notified the parties on March 28, 2012 that the AL is suspended for up to 120 days.

10 In DRA's protest to the instant application filed on December 15, 2011, DRA lists
11 several issues of concern to the ratepayers such as real benefits to the ratepayers, financial
12 risk and other risks the ratepayers have to bear, anti-competitive issues between public
13 utilities versus the private industry, and the mechanics to make the ratepayers financially
14 whole.¹¹ The Assigned Commissioners Scoping Memo incorporated and summarized the
15 principal issues to be:

- 16 1. Is the Application and proposed service consistent with
17 policies adopted by the Commission, or do Commission
18 policies preclude the provision of this service by
19 SoCalGas?
20
- 21 2. Are the terms of the tariff-anti competitive, as alleged by
22 protestants? Does the tariff cover the service costs?
23
- 24 3. Are the proposed rates just and reasonable, so as to
25 warrant the granting of the Application?
26

27 Consistent with the Scoping Memo, DRA's report addresses these issues.
28
29

¹¹ See <http://docs.cpuc.ca.gov/efile/P/156022.pdf>

1 **CHAPTER 2 SUMMARY OF DRA FINDINGS AND**
2 **RECOMMENDATIONS**

3 DRA’s analysis of SoCalGas A.11-11-011 shows:

- 4 1. As a threshold issue, SoCalGas A.11-11-011 is not consistent with policies
5 adopted by the Commission and Commission policies preclude SoCalGas from
6 offering this service, therefore DRA recommends the Commission deny the
7 Application.
- 8 2. The terms of SoCalGas’ proposed tariff are anti-competitive as SoCalGas
9 would be allowed to use embedded costs authorized in previous General Rate
10 Cases and be able to finance gas compression facilities with a low cost of
11 capital and enjoy a guaranteed rate of return on investment, advantages that are
12 not available to non-utility competitors. Also, in the event that SoCalGas does
13 not recover 100% of the fully loaded costs from each customer under the tariff,
14 the tariff for the gas compression service could result in below-cost prices
15 which would provide SoCalGas with an additional advantage over non-utility
16 competitors.
- 17 3. It is unclear whether the tariff would cover the fully loaded costs of the service.
18 SoCalGas does not provide enough detail to insure that all costs associated
19 with the Application can be identified.
- 20 4. The Commission should analyze the process and cost estimates used by
21 SoCalGas to estimate the tariff for AL 4337. This will help determine the rigor
22 and reasonableness of the processes and estimates involved in defining a
23 specific gas compression service tariff.
- 24 5. There are no substantial, tangible ratepayer benefits associated with the
25 Application but yet ratepayers take on most of the downside risk of the
26 Application.
- 27 6. On the other hand, SoCalGas shareholders accrue all of the financial benefits
28 of the Application but take on little risk associated with the Application.

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CHAPTER 3 DISCUSSION

A) A.11-11-011 IS NOT CONSISTENT WITH PRIOR COMMISSION DECISIONS REGARDING UTILITY INVOLVEMENT IN THE MARKET FOR NATURAL GAS VEHICLES (NGVs)

Decision (D.) 93-07-054 and 95-11-035 are the two most recent Commission decisions which provide guidance regarding utility ownership (in whole or part) of natural gas refueling stations. In the 1993, D.93-07-054, the Commission articulated requirements for utility involvement in the Natural Gas Vehicle (NGV) industry, specifically:

- “Any recovery from ratepayers of costs associated with these activities is to be limited to programs found by the Commission to be *substantially in the ratepayers’ long-term interests.*”¹² (emphasis added)
- “Utility involvement, we declare, should ... avoid any unfair competition with non-utility enterprises.”¹³
- “... and it is the responsibility of the Commission to see that utility presence is compatible with the emergence of competition in all sectors of this industry.”¹⁴
- “The requirement that the utility’s Low-emission Vehicle (LEV) programs not be anti-competitive is derived from the Commission’s general responsibility to guard against anti-competitive utility behavior and from the specific language in PUC Sections 740.3 and 745.5.” (Finding of Fact (FoF) #19)
- “The preclusion of unfair competition governs markets where there currently is no competition as well as those where there currently is.” (FoF #20)

D.93-07-054 makes it abundantly clear that utility involvement in the NGV and LEV markets must be limited to programs that the Commission finds are both “substantially in the ratepayers long-term interest” and do not unfairly compete with non-utility enterprises.

¹² Page 456, CALIFORNIA PUB. UTIL. COMM’N – 50 CPUC 2d.

¹³ Page 457, CALIFORNIA PUB. UTIL. COMM’N – 50 CPUC 2d.

¹⁴ Page 458, CALIFORNIA PUB. UTIL. COMM’N – 50 CPUC 2d.

1 In 1995, the Commission went one step further to enhance competition in the NGV
2 market in D.95-11-035. In this decision, the Commission flatly prohibited ratepayer funds
3 from being used to fund natural gas refueling stations on customer property and ordered the
4 utilities, including SoCalGas, to sell off all utility-owned NGV refueling stations located on
5 customer property.^{15,16} The decision states:

- 6 • "... we will not allow the utilities to recover costs for any new stations on
7 customer property for which contracts had not been signed as of the date of
8 issuance of the ALJ's proposed decision in this matter."¹⁷
- 9 • "... we will require the utilities to remove all customer-site stations from
10 ratebase when they are sold, or six years from the effective date of this
11 decision, whichever comes first."¹⁸
- 12 • "There are many companies that are interested in competing in the market for
13 the construction and operation of refueling stations..."¹⁹
- 14 • "Any future utility refueling station program must be designed to avoid giving
15 the utility any market advantage, based on its monopoly status."²⁰
- 16 • "If the utilities are confident that a refueling station program would succeed,
17 and if they can design a program that would compete fairly, they should be
18 allowed to use shareholders funds to do so."²¹

19 D.95-11-035 determined that for competition to flourish in the NGV fueling station
20 market, the utilities would have to exit the market. The Commission found it is unfair

¹⁵ Page 444, CALIFORNIA PUB. UTIL. COMM'N – 62 CPUC 2d.; ; SoCalGas response to DRA data request SCGA1111011-DRA-DBP-1 (see attachment A), question 13: clarified that D.95-11-035 permitted SoCalGas to maintain NGV fueling stations on utility property.

¹⁶ White Paper: *What is the Appropriate Role of Natural Gas Utilities in the Natural Gas Vehicle Refueling Market?*, Covington & Burling LLP, November 1, 2011, p. 14 (see Attachment 2).

¹⁷ Page 442, CALIFORNIA PUB. UTIL. COMM'N – 62 CPUC 2d.

¹⁸ Page 444, CALIFORNIA PUB. UTIL. COMM'N – 62 CPUC 2d.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

1 competition where utilities can rely on captive ratepayers to subsidize the cost of compressed
2 gas service but non-utility competitors are forced to rely on retained earnings to finance the
3 same types of facilities.²²

4 The Commission stated very clear policy preferences regarding utility involvement in
5 the NGV refueling market in D.93-07-054 and D.95-11-035. Decision D.93-07-054 and
6 more so D.95-11-035 is very clear that utilities should not own or utilize ratepayer funds to
7 subsidize development (in part or whole) NGV refueling stations on customer property.
8 During the course of this proceeding, DRA will indeed show that the Commission prohibits
9 such subsidization. Given these Commission policies, A11-11-011 is likely inconsistent
10 with D.95-11-035 in a number of ways. First, in A.11-11-011, SoCalGas proposes to own
11 and operate gas compression facilities for NGV refueling stations on customer property.²³
12 This seems to be contrary to the Commission’s D.95-11-035 policy preference to disallow to
13 utility ownership (in part or whole) NGV refueling stations on customer property. Second,
14 SoCalGas proposes to use embedded costs already included in general rates. Essentially,
15 ratepayers will float SoCalGas the necessary funds to provide the Compression tariff until
16 such time when the revenues received for the services are incorporated into rates.²⁴ Again,
17 D.95-11-035 states that it is unfair for utilities to be able to rely on captive ratepayers to fund
18 compressed gas facilities. Likewise, D.95-11-035 states that utilities should use shareholder
19 funds to finance gas compression facilities. For these reasons, DRA recommends the
20 Commission to deny A.11-11-011 or alternatively instruct SoCalGas to file a Petition to
21 Modify D.95-11-035.

22

²² Page 453, CALIFORNIA PUB. UTIL. COMM’N – 62 CPUC 2d.

²³ Lines 16 to 21, Page 2, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

²⁴ Lines 17 to 23, Page 2, Chapter III, Prepared Direct Testimony of Edward J. Reyes, A.11-11-011, November 3, 2011.

1 **B) SOCALGAS’ REPRESENTATION OF PUBLIC UTILITIES CODE 740.3 IS**
2 **INCOMPLETE**

3 SoCalGas relies on Public Utilities Code (PUC) Section 740.3 to suggest that A.11-
4 11-011 is consistent with Commission policy.²⁵ Though SoCalGas correctly states that
5 740.3 directs the Commission to implement policies designed to promote the development of
6 infrastructure to facilitate the use of natural gas low-emission vehicles, SoCalGas omits the
7 critical condition 740.3(c) which requires “The commission’s policies shall also ensure that
8 utilities do not unfairly compete with nonutility enterprises.”
9

10 **C) SOCALGAS’ PROPOSED TARIFF IS ANTI-COMPETITIVE AS SOCALGAS**
11 **WILL ENJOY SEVERAL MARKET ADVANTAGES BASED ON ITS**
12 **MONOPOLY STATUS**

13 The terms of SoCalGas’ proposed tariff are anti-competitive as SoCalGas would
14 enjoy several market advantages based on its monopoly status. First, as mentioned above,
15 SoCalGas proposes to use embedded costs authorized in previous General Rate Cases to in
16 part provide the upfront funding to finance gas compression facilities whereas non-utility
17 competitors are forced to use retained earnings to fund new gas compression facilities.
18 Second, as a regulated monopoly utility, SoCalGas benefits from a lower cost of capital than
19 a non-utility competitor. Third, as a regulated utility SoCalGas is authorized a relatively
20 high rate of return on investment unlike a non-utility which has no assurance of a return at
21 all. Fourth, SoCalGas could unintentionally or intentionally choose to exclude certain costs
22 (e.g., taxes, certain O&M expenses, early market outreach) from the “fully loaded costs” of
23 each project and recover those excluded costs outside the program subsidized by non-
24 participating ratepayers. This practice could result in below-cost prices that SoCalGas could
25 charge for gas compression services which would undercut the market. Fifth, SoCalGas
26 could favor and prioritize interconnecting SoCalGas gas compression services non-utility gas
27 compression projects. D.95-11-035 specifies that any future utility NGV refueling program

²⁵ A.11-11-011, p. 3.

1 must be designed to avoid giving the utility any market advantage (emphasis added).²⁶ But
2 as proposed, A.11-11-011 has many anti-competitive design flaws.

3

4 **D) SOCALGAS DOES NOT PROVIDE A SUFFICIENT LEVEL OF DETAIL TO**
5 **DETERMINE WHETHER THE TARIFF WOULD COVER THE FULLY**
6 **LOADED COSTS OF THE SERVICE**

7 It is unclear whether the tariff would cover the fully loaded costs of the service.
8 SoCalGas does not provide enough detail to insure that all costs associated with the
9 Application can be identified. For the tariff to fully cover all costs, SoCalGas must estimate
10 with great accuracy the necessary monthly charge for the gas compression customer. This
11 requires SoCalGas to predict with pinpoint accuracy what every individual cost element that
12 would be incurred for the entire service life of the gas compression service. This seems to be
13 an exercise in futility as SoCalGas could rarely predict with any accuracy how much actual
14 development costs would be prior to construction or how much O&M or administrative costs
15 would be over a twelve year period. Likewise, if SoCalGas employees are not reporting
16 their labor hours accurately, the tariff may not cover all costs of the service.

17 An additional problem is due to SoCalGas' design of A.11-11-011. Specifically,
18 SoCalGas states that customers that are interested in taking service under the tariff will
19 request a preliminary assessment of feasibility and cost. SoCalGas goes on to state that these
20 high-level assessments will be covered through indirect charges.²⁷ If SoCalGas ends up
21 performing many initial high-level assessments that do not result in a completed gas
22 compression project, these indirect costs would not be covered by the tariff and would need
23 to be recovered elsewhere.

24 Another concern that the tariff may not cover all the program costs is based on the
25 fact that prospective tariff customers will be required to fund any required site evaluation and

²⁶ Page 444, CALIFORNIA PUB. UTIL. COMM'N – 62 CPUC 2d.

²⁷ Lines 14 to 17, Page 22, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

1 design activities prior to execution of a tariff agreement.²⁸ DRA cannot find this requirement
2 specified anywhere in SoCalGas Testimony Appendix A (Proposed Tariff) or Appendix B
3 (Compression Services Agreement). If this requirement is not fully enforced, site evaluation
4 and design activities that do not result in a completed project could also result in stranded
5 costs in the event the prospective customer fails to cover these costs.

6 Finally, SoCalGas only provides broad activity descriptions that are required to
7 deliver the tariff services (e.g., Customer Outreach, Contract Development, Engineering and
8 Cost Estimation, Procurement and Construction, etc.).²⁹ For the Commission to have more
9 confidence that the tariff will truly cover all costs, SoCalGas should have activities broken
10 down to a very granular level and tracked at a granular level. This will help ensure that all
11 costs are accounted for and all costs are tracked.

12
13 **E) THE COMMISSION SHOULD ANALYZE THE PROCESS AND COST**
14 **ESTIMATES USED BY SOCALGAS TO ESTIMATE THE TARIFF FOR AL**
15 **4337**

16 To help answer the Scoping Memo issue of whether the tariff will cover the service
17 costs, the Commission should analyze the process and cost estimates used by SoCalGas to
18 estimate the tariff for AL4337. Per an April 27, 2012 meeting between DRA, SoCalGas, and
19 LAUSD, it is DRA’s understanding that the terms of the Proposed Tariff and the
20 Compression Services Agreement are “virtually identical” between SoCalGas AL 4337 and
21 A.11-11-011. Based on this assumption, reviewing the confidential negotiated contract
22 terms between SoCalGas and LAUSD will shed light on the rigor and reasonableness of the
23 monthly service fee that SoCalGas arrived at to fully recover all costs of the proposed
24 LAUSD gas compression facility. In addition, the Commission should, on a confidential
25 basis, compare the costs charged by SoCalGas for the proposed LAUSD gas compression

²⁸ Lines 17 to 19, Page 22, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

²⁹ Lines 1 to 7, Page 22, Chapter II, Services, Customer Demand and Benefits, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

1 facility and those offered by other non-utility market participants to help determine if
2 SoCalGas is undercutting the market.³⁰ AL 4337 Confidential Attachment D shows
3 SoCalGas' LAUSD Service Fee Calculation though it is unclear to DRA how any of the
4 numbers in Attachment D are arrived at. SoCalGas should be required to develop and
5 distribute workpapers which clearly and transparently demonstrate the translation of the
6 proposed LAUSD facility requirements to the monthly service fee that SoCalGas will charge
7 LAUSD in order to recover all costs. SoCalGas should also be required to provide
8 workpapers which transparently divulge all SoCalGas costs and resources utilized to-date in
9 the development of the LAUSD facility design/proposed tariff/compression service
10 agreement, construction of the facility, and administration of the project. SoCalGas should
11 also explain the funding source for the project (i.e., ratepayers, embedded resources,
12 shareholders).

13

14 **F) THERE ARE NO SUBSTANTIAL, TANGIBLE RATEPAYER BENEFITS**
15 **ASSOCIATED WITH THE APPLICATION YET RATEPAYERS TAKE ON ALL**
16 **OF THE DOWNSIDE RISK OF THE APPLICATION**

17 SoCalGas claims that ratepayers receive financial and environmental benefits from
18 the proposed tariff.³¹ But SoCalGas has not demonstrated in the application that ratepayers
19 indeed will receive any substantial or tangible financial benefits. However, the ratepayers
20 will bear substantial financial downside risk.

21 DRA's analysis of SoCalGas A.11-11-01 has shows there is no financial upside for
22 ratepayers, only substantial downside risk. SoCalGas claims that any resources or costs
23 incurred in providing the gas compression service will be properly tracked and ratepayers
24 will be credited for any embedded costs already included in general rates.³² Essentially,

³⁰ Per the April 27, 2012 meeting between DRA, SoCalGas, and LAUSD it is DRA's understanding that LAUSD solicited bids (but did not hold a competitive Request for Offers (RFO)) from at least two non-utility market participants, one or both of which are intervenors in this proceeding.

³¹ Lines 5 to 6, Page 4, Chapter I, Policy Support, Prepared Direct Testimony of Jeffrey G. Reed, A.11-11-011, November 3, 2011.

³² Lines 17 to 23, Page 2, Chapter III, Prepared Direct Testimony of Edward J. Reyes, A.11-11-011,

(continued on next page)

1 SoCalGas proposes that ratepayers float the funds and resources needed to implement the
2 service and at a later date (which is undefined) SoCalGas will credit ratepayers back the
3 equivalent amount so that ratepayers remain “square.” One obvious problem with this plan
4 is that if SoCalGas does not properly track and account for every cost and do so diligently
5 for the life of the program, then ratepayers may not be fully repaid. Along these lines it is
6 also unclear how long it will take for ratepayers to be fully paid back. Does this occur before
7 the gas compression facility goes into production or at the end of the 12-20 year life of the
8 facility or later? SoCalGas does not appear to be offering ratepayers any interest on the costs
9 and resources used to front service. These are only a couple of the many risks that ratepayers
10 would take on under SoCalGas’ proposal.

11 Another substantial risk ratepayers take on is in the event that a customer of the gas
12 compression service for one reason or another, abandons the property, goes bankrupt,
13 cancels the project midstream, stops paying the monthly service fee, or sells the property to a
14 new owner who does not want the service. SoCalGas claims it will first exhaust all
15 commercial and legal remedies to collect the remaining balance due or costs to try and
16 redeploy the assets.³³ But if the asset cannot be redeployed it will be retired and the
17 underdepreciated capital invested is rolled-in to ratebase along with the revenue forecasts
18 associated with the services. That means that ratepayers would end up ultimately paying so
19 that SoCalGas suffers no loss. SoCalGas claims that parties such as DRA could fight to keep
20 those losses and revenues from being rolled into ratebase but the onus would be on
21 intervenors to stop that from happening. Again, no upside, only potential downside risk.

22 Another substantial risk is in the event that SoCalGas decides to or is ordered to sell
23 existing gas compression facilities.³⁴ If this would occur, there could be more losses that
24 SoCalGas would try to recover in the next GRC. In 1995, D.95-11-035 removed the
25 authority for SoCalGas to recover costs for NGV refueling facilities. The facilities that

(continued from previous page)
November 3, 2011.

³³ SoCalGas response to DRA data request SCGA1111011-DRA-DBP-1(see attachment A), question 3b.

³⁴ SoCalGas response to DRA data request SCGA1111011-DRA-DBP-1(see attachment A), question 13.

1 SoCalGas sold originally cost \$40 Million but only sold for \$2.7 Million.³⁵ Again, in this
2 event, SoCalGas would be expected to try and recover the loss from ratepayers in the next
3 GRC. More downside, no upside for ratepayers.

4 Another risk ratepayers would take on is liability during the construction and
5 operation of the gas compression facility. There could be an accident or explosion of some
6 sort. DRA understands that the insurance policies that SoCalGas currently carries would be
7 used in this case.³⁶ This appears to be a cross subsidy in that the gas compression services
8 would now be piggybacking on the insurance policy that ratepayers are funding for other
9 purposes. In the end, ratepayers would be taking on additional liability risk from the gas
10 compression services program. More downside for ratepayers, no upside.

11 All of these examples show some of the substantial risks that SoCalGas' ratepayers
12 would take on under A.11-11-011. As stated earlier, the best that ratepayers can do
13 financially under the A.11-11-011 is to break even.³⁷ Decision D.93-07-054 gave clear
14 direction that recovery of costs associated compressed natural gas fueling facilities is to be
15 limited to programs are substantially in the ratepayers long-term interests. There is nothing
16 in A.11-11-011 that is in the ratepayers long-term interest, only downside risk.

17 In regard to the environmental benefits, the current application lacks measurements to
18 determine the extent that environmental benefits are accrued. The Commission has already
19 established numerous programs to further environmental policies to benefit the general
20 public. Ratepayer money would be more effectively spent by enhancing already established
21 and known programs that lack uncertainty, do not involve startup costs, and are less risky for
22 ratepayers.

23

³⁵ White Paper: *What is the Appropriate Role of Natural Gas Utilities in the Natural Gas Vehicle Refueling Market?*, Covington & Burling LLP, November 1, 2011, p. 14 (see Attachment 2).

³⁶ SoCalGas response to DRA data request SCGA1111011-DRA-DBP-1(see attachment A), question 3a.

³⁷ Page 456, CALIFORNIA PUB. UTIL. COMM'N – 50 CPUC 2d.

1 **G) SOCALGAS SHAREHOLDERS ACCRUE ALL OF THE FINANCIAL BENEFITS**
2 **OF THE APPLICATION BUT TAKE ON VERY LITTLE RISK**

3 From the standpoint of SoCalGas shareholders, A.11-11-011 is a no-lose proposition.
4 Shareholders need not invest in the gas compression service program as SoCalGas will use
5 existing embedded resources authorized in previous GRCs to do the work. SoCalGas will
6 own all of the gas compression service assets and will earn its authorized rate of return.
7 SoCalGas would expand its operation into the gas compression business on customer
8 property even though the Commission has banned this arrangement. If there is an accident
9 or explosion, ratepayer funded insurance will cover any liability. As described above, in the
10 event that there are any losses or lost revenue associated with a gas compression facility,
11 SoCalGas would roll those loses into ratebase at the next GRC cycle. From a SoCalGas
12 shareholder standpoint, A.11-11-011 is all upside, no downside risk.

13
14

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ATTACHMENT 1

2

1 **Question 1**

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3 Please explain in detail and quantify all benefits that would accrue to SCG ratepayers as a
4 result of this application. Attach all spreadsheets with formulas if applicable.

5

6 **Response 1**

7 Please see application testimony, Chapter II, Section IV “Ratepayer Benefits,” pp.
8 23-27, and supporting workpapers to the testimony of Jeffrey Reed, Workpapers 9,
9 10, 11, and 13. As outlined in the referenced testimony, the proposed service will
10 provide both financial and environmental benefits to ratepayers.



Ch 2 Reed
Testimony.pdf

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Question 2

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Please explain in detail and quantify all costs that would accrue to SCG ratepayers as a result of this application. Attach all spreadsheets with formulas if applicable.

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Response 2

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11

No incremental costs will accrue to ratepayers as a result of this application. As stated in application testimony, Chapter I, p.2, (attached) “the proposed tariff is designed not to burden non-participating ratepayers with the cost of providing the service.”

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Ch 1 Reed
Testimony.pdf

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3 **Question 3**
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5 Please explain in detail and quantify all of the risks that are associated with this application.
6 For each risk explain whether the risk is assumed by SCG shareholders, SCG ratepayers,
7 or customers of the gas compression service. For example:
8

- 9 a. Please explain in detail any liability risks associated with the construction of or
10 operation of the gas compression services. Who takes on those risks (i.e., SCG
11 shareholders, SCG ratepayers, customers of the gas compression service)?
12
13 b. Are there any risks associated with stranded assets that would occur during
14 construction of the compression service facilities or after the facilities are built?
15 For example, the customer cancels service prior to the specified termination
16 date, or the customer defaults on the contract, or the customer sells the site?
17 Who takes on those risks (i.e., SCG shareholders, SCG ratepayers, customers of
18 the gas compression service)?
19

20 **Response 3**
21

- 22 a. The risks associated with this application can be broadly divided into two areas of
23 liability: (i) those associated with Applicant's facilities, and (ii) those associated
24 with SoCalGas' facilities. In Section 7.c. of the Proposed Tariff located in
25 Appendix A of the Compression Services Application (attached), Applicant is
26 responsible for ensuring that its own facilities are properly planned, designed,
27 installed, constructed, maintained and operated to receive and dispense
28 compressed natural gas and that its facilities comply with applicable standards
29 and laws. In addition, in Section 7.f. of the Proposed Tariff, SoCalGas is not
30 responsible for any damage, loss or injury resulting from Applicant's facilities,
31 and in Section 7.h., Applicant indemnifies SoCalGas for pre-existing
32 environmental liability. As additional protection for Applicant's facilities, the
33 Compression Services Agreement located in Appendix B, Section 7 of the
34 Compression Services Application (attached), requires Applicant to obtain and
35 maintain at Applicant's sole cost and expense the insurance coverage for the
36 entire term of this Agreement to insure against any and all liabilities, claims,
37 losses, damages or expenses related to Applicant's facilities. With respect to
38 SoCalGas' compression facilities, there is potential liability during construction
39 and operation phases. During construction, SoCalGas requires its contractors to
40 carry liability insurance in an amount to be determined based on the size of the
41 project. After the compression facilities are in service, any liability related to the
42 compression facilities are covered in accordance with SoCalGas' standard
43 protections for ratebase assets.



AppendixB_Compres sionAgreement.pdf



AppendixA_Tariff.pdf

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- b. As with any other tariff service, the infrastructure assets used in providing that service are ratebase assets and any customer specific charges are treated as miscellaneous revenues. If SoCalGas constructs and places into operation a compression facility on behalf of a customer, that specific customer will be charged the full cost of service including capital, O&M and all applicable overheads. Those assets will be incorporated into ratebase and the associated customer revenues will become part of miscellaneous revenues in the next GRC proceeding. If a Compression Services Tariff customer files for bankruptcy, cancels service, or is ultimately unable to pay for any reason for the infrastructure installed on its behalf, SoCalGas will first exhaust all commercial and legal remedies to collect the remaining balance due and the required costs to remove and redeploy the asset from the customer premises. If not redeployed the asset will be retired. SCG shareholders bear the economic loss between GRCs until the undepreciated capital invested is rolled-in to ratebase along with miscellaneous revenues forecasts associated with compression services tariff for approval in the subsequent GRC.

1 **Question 4**

2
3 On Testimony Chapter 2, page 2, lines 1-2, SCG specifies that it developed the
4 Compression Services Tariff in response to customer inquiries.

- 5
6 a. How many and on what dates did SCG receive customer inquiries in regards to
7 gas compression services?
8
9 b. Please send electronic copies of all customer inquiries that SCG received in
10 regards to gas compression services.
11

12
13
14 **Response 4**

- 15
16 a. SoCalGas did not maintain specific records on customer inquiries prior to
17 development of a formal gas compression service proposal. The statement
18 was based on requests made from time to time by customers about the
19 possibility of SoCalGas constructing and operating gas compression services
20 on customer property to provide fuel to customer operated vehicle fleets.
21 Customer interest was confirmed in a formal survey(see attached file)
22 referenced in the direct testimony of Jeffrey Reed - Services, Customer
23 Demand, and Benefit testimony, Chapter 2, pages 15-18 and Appendix C. In
24 the survey, 94% of customers (60 out of 64 responding) found the proposed
25 service “beneficial” and 77% of customers (49 out of 64 responding) stated
26 that the proposed service would make them more likely to build a new CNG
27 station or replace/enhance an existing one.



AppendixC _
Survey.pdf

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30 b. See Response to Question 4a.
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3 **Question 5**
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5 In Chapter II, page 14, lines 14-15, the witness specifies that gas compression services can
6 be provided by customers or third parties.
7

- 8 a. Please identify all SCG customers that currently provide their own gas
9 compression services.
10
11 b. For all third parties that already provide gas compression services in SCG's
12 service territory, please specify the following information: physical mailing
13 address, internet address, contact information, pricing options for gas
14 compression services.
15
16

17 **Response 5**
18

- 19 a. There are approximately 171 individual customers that own and operate
20 compressed natural gas vehicle refueling stations.
21 b. As part of the SoCalGas NGV customer information, education and training
22 program, we provide customers with a list of NGV-related vendors that
23 includes "CNG Fuel Station Provider/Packager" (see attached file). Please
24 note that pricing options vary by vendor and project and is often confidential,
25 so that information is unavailable to SoCalGas.



022212 SoCalGas
Supplier Directory.pdf

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Question 6

In Chapter III, page 9, lines 3-5, the witness states that SCG’s GRC filing, currently before the CPUC, contains no requests for additional funding for the Compression Services Tariff activities in the test year or any forecasted revenues from offering the service did SCG consider this proposal prior to the GRC (or any opportunity after allowing SCG to amend its GRC testimony)? If so, please indicate the rational for not including the request in the GRC.

Response 6

Although the proposed tariff is not limited to natural gas vehicle applications, it was the judgment of SoCalGas to wait until a CPUC decision was issued related to the Order Instituting Rulemaking on the Commission's own motion to consider alternative-fueled vehicle tariffs, infrastructure and policies to support California's greenhouse gas emissions reduction goals. On July 14, 2011, the CPUC approved D.11-07-029, “Phase 2 Decision Establishing Policies to Overcome Barriers to Electric Vehicle Deployment and Complying with Public Utilities Code 740.2”. No new policy was set relative to Natural Gas Vehicle infrastructure and SoCalGas deemed the timing to be appropriate to file the Compression Services Tariff. Our GRC Application was filed on December 15, 2010.

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Question 7

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In Chapter III, page 9, lines 15-16, the witness states that the Compression Services Tariff charges consist of two components: (1) Ownership Charge; and (2) Operation & Maintenance (O & M) Charge. Will the tariff charges include the entire rate base revenue requirement necessary for the service life for all capital additions? Please show this analysis on a year by year basis for the service life of the capital additions. Attach all spreadsheets with formulas if applicable.

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13

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Response 7

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16

Per our meeting on February 29, 2012 – The tariff charges will include the entire rate base revenue requirement necessary for the service life for all capital additions. As stated in application testimony located in Chapter III, section IV, page 9, line 22 through page 13 line 2, which is attached, provides an example of how this will be accomplished.

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Ch 3 Reyes
Testimony.pdf

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Question 8

In Chapter III, page 8, lines 8-11, the witness states that the accounting methods described above are designed to ensure that the service provided under the tariff for Compression Services Tariff customers are appropriately tracked on a fully loaded basis and that ratepayers are credited for any costs embedded in general rates, until such until such time as the miscellaneous revenues received for these services are incorporated into rates. For the example project described on Chapter III, pages 9-12 please show, on a year by year basis, how the SCG ratepayers are credited for any costs embedded in general rates. Provide this analysis in an excel spreadsheet with all formulas intact.

Response 8

Per our meeting on February 29, 2012 and as described in Chapter III, page 9, line 3-5 "SoCalGas" general rate case ("GRC") filing, currently before the California Public Utilities Commission ("CPUC"), contains no requests for additional funding for the Compression Services Tariff activities in the test year or any forecasted revenue from offering the service." The example project described on Chapter III, pages 9-12, is for illustrative purpose for the calculation of the compression services charges and did not assume any costs associated with the use of SoCalGas' existing resources that are recovered through SoCalGas' authorized base margin. However, to the extent that SoCalGas uses its existing resources to provide compression services, SoCalGas shall reimburse ratepayers by adjusting its fixed cost balancing accounts as described in the application testimony located in Chapter III, pages 11, lines 9-16, and page 12, lines 17-22 (see Chapter 3 testimony located in response 7). The balance in these fixed cost balancing accounts will be amortized in rates in connection with SoCalGas' annual regulatory account balance update filing for rates effective January 1 of the following year.

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Question 10

In Chapter III, page 2, the witness specifies that all costs incurred in providing service under the Compression Services Tariff are properly tracked and ratepayers are credited for any embedded costs already included in general rates. And on the following pages the witness specifies that many of the direct cost activities will be performed by utility staff and utility Account Managers. How much excess resources are available from the embedded resources approved in the GRC to implement the Compression Services Tariff?

Response 10

The utility groups that would be needed to implement Compression Services do not have any excess resources. However, to the extent that SoCalGas uses its existing resources to provide compression services, SoCalGas shall reimburse ratepayers by adjusting its fixed cost balancing accounts as described in application testimony located in Chapter III, pages 11, lines 9-16, and page 12, lines 17-22 (see Chapter 3 testimony located in response 7) .

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Question 11

In Chapter III, page 12, lines 1-3, the witness refers to the revenues from the specific Compression Services Tariff customers in both the interim period and the next GRC cycle cover the cost of providing the service, including a return on investment to the shareholders. Please quantify the return on investment to the shareholders. Is this return, the only shareholder benefit that accrues to shareholders as a result of this application?

Response 11

The return on investment to shareholders will be SoCalGas' authorized rate of return.
This is the only benefit to shareholder._

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3 **Question 12**
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5 In Chapter III, page 9, the witness specifies that by separately tracking all Compression
6 Services Tariff costs, SCG will ensure that appropriate pricing is developed that is sufficient
7 to recover the costs associated with compression services. Please provide a comparison of
8 the current gas compression service market costs with SCG's proposed appropriate pricing
9 for comparable services. How does SCG know that the SCG appropriate pricing will be
10 competitive with the market competitors in SCG's service territory?
11

12 **Response 12**
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14

15 Project costs and pricing will vary depending on the scope, and location of individual
16 projects. Therefore, the cost of compression services is unique for each customer
17 application. There are no comparable compression services market costs available
18 for comparison since CNG retail prices are marketed at a dollar per Gasoline Gallon
19 Equivalent (\$/GGE) rate and wholesale prices are generally not available. However,
20 based on expected levels of facility utilization, SoCalGas believes that Compression
21 Services Tariff customers will be able to produce CNG for their vehicles at costs that
22 compare favorably to historical CNG retail prices. For instance, to determine the
23 cost per GGE using the SoCalGas Compression Services Tariff the customer will
24 need to add the following costs: Monthly compression tariff charge, electric cost for
25 the SoCalGas Compressors, 3rd Party fee to own operate and maintain station,
26 Monthly tariff commodity and transportation charge (G-NGU) divided by the GGEs
27 used per month.
28

29 A hypothetical example is provided below.
30
31

<i>Monthly CNG Price Per Gasoline Gallon Equivalent (GGE)</i>	
<i><u>Monthly CNG Station Expenditures</u></i>	<i><u>Cost</u></i>
Compression Cost	\$ 12,000.00
Electricity Cost	\$ 1,500.00
3rd Party fee to own operate and maintain station	\$ 3,000.00
Natural Gas Procurement and Transportation	\$ 10,000.00
<i><u>Total monthly Expenditures</u></i>	<i><u>\$ 26,500.00</u></i>
<i><u>Equivalent price per GGE at 12,000 GGE/mo:</u></i>	<i><u>\$</u></i>

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3 **Question 13**
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6 DRA understands that SCG has been involved in providing gas compression services in
7 the past.

- 8
9 a. Please provide the historical context of SCG’s involvement in gas compression
10 service in the past.
11
12 b. How many gas compression service installations has SCG installed in the past?
13 Does SCG still own any of these facilities? When has SCG sold off any of these
14 facilities in the past?
15
16 c. Please provide insight on any Commission proceedings and Commission
17 Decisions regarding gas compression services.
18
19

20 **Question 13**
21

22 SoCalGas has not previously provided gas compression services as proposed in the
23 current Application. SoCalGas has provided, and provides now, some services that
24 include compression as part of the service, most notably NGV refueling services.
25 This is described below:
26

- 27 a. In the context of NGV refueling services, SoCalGas has provided gas
28 compression for CNG vehicles since 1992. D.95-11-035 removed the
29 authority existing at the time for SoCalGas to recover costs for NGV
30 refueling facilities located on customer property through general rates.
31 SoCalGas was permitted to continue to recover costs through general
32 rates for fueling stations on utility property for the purpose of refueling
33 utility vehicles. SoCalGas continues to provide public access at 10 of these
34 facilities, for which incremental service ratepayer costs are offset through
35 the G-NGC Compression Surcharge.
36
37 b. Prior to D.95-11-035, SoCalGas installed approximately 64 CNG vehicle
38 refueling stations on both customer property and at utility bases. D.95-11-
39 035 ordered SoCalGas to sell or remove all SoCalGas owned CNG vehicle
40 refueling stations on customer property within six years of the Decision,
41 which SoCalGas did. Currently SoCalGas owns and operates 17 CNG
42 vehicle refueling stations at utility bases.
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c. With respect to NGV refueling, the Commission first authorized ratepayer-funded infrastructure for NGVs in D.91-07-018 (for PG&E). In D.93-07-054, the Commission adopted guidelines for approval of ratepayer funding for low-emission vehicle (LEV) activities. In D.95-11-035, the Commission limited the extent to which ratepayer funds could be used for LEV infrastructure projects. On July 21, 2005, Senate Bill 76 was signed by the Governor of California. Senate Bill 76 changed Public Utilities Code 740.8, effective January 1, 2006, to read as follows: "As used in Section 740.3, "interests" of ratepayers, short- or long-term, mean direct benefits that are specific to ratepayers in the form of safer, more reliable, or less costly gas or electrical service, consistent with Section 451, and activities that benefit ratepayers and that promote energy efficiency, reduction of health and environmental impacts from air pollution, and greenhouse gas emissions related to electricity and natural gas production and use, and increased use of alternative fuels." As a result, the definition of ratepayer "interests", as used in Public Utilities Code 740.3 and used to develop current Commission policy in D.95-11-035, was changed and substantially expanded. More recently, the alternative fuel vehicle OIR (R.09-08-009) included NGV issues in scope, but ultimately did not change policy.

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Question 14

Please provide the market outlook and any studies regarding the gas compression service market in SCG’s service territory.

Response 14

Please see application testimony located in Chapter II, p.15 for SoCalGas’ assessment of the market for gas compression among NGV refuelers, and p.18 for the market assessment among CHP operators (see Chapter 2 testimony located in response 1).

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ATTACHMENT 2

WHITE PAPER

**WHAT IS THE APPROPRIATE ROLE OF NATURAL
GAS UTILITIES IN THE NATURAL GAS VEHICLE
REFUELING MARKET?**

Prepared By

**William Massey
Robert Fleishman
Wilbur Earley
Whitney Gallagher**

Covington & Burling LLP

November 1, 2011

I. Executive Summary

The use of natural gas as a transportation fuel is a rapidly growing market segment in the United States with substantial, untapped growth potential. The key factors driving this trend are the significant price advantage of natural gas as a vehicle fuel over gasoline and diesel fuels, the abundance of domestic natural gas supplies, an increasing awareness of the environmental benefits of using natural gas as a transportation fuel, and an enhanced recognition of the need to address the national security implications of our nation's excessive dependence on imported crude oil and petroleum transportation fuels.

State-regulated natural gas distribution companies (often known as "gas utilities") in the United States have a growing interest in the natural gas vehicle ("NGV") refueling market because of potential load growth associated with the market. Importantly, however, unlike the monopoly distribution markets that these regulated gas utilities currently serve, the NGV refueling market is a competitive business. Accordingly, non-utility enterprises — not state-regulated natural gas distribution utilities — should build the refueling stations and provide the bulk of the services needed for this market to grow and prosper.

There are several reasons why gas utilities should not build the needed NGV refueling stations. First, there is no need for gas utility involvement because non-utility enterprises have entered, and will continue to enter, the market and build the needed NGV refueling stations. The price advantage of natural gas over gasoline and diesel provides an economic incentive for non-utility enterprises to enter the market, there are no substantial barriers to building NGV refueling stations, and there is sufficient capital available to the private enterprises. Second, if state-regulated gas utilities build NGV refueling stations to compete directly with stations owned by

non-utility enterprises, the market distortions and unfair competition that are likely to result will mean fewer stations and higher costs to consumers because full recovery of refueling station costs from utility ratepayers reduces the pressure to keep costs down. Third, gas utility ratepayers should not be forced to finance the construction of gas utility-owned refueling stations when non-utility enterprises are willing to build the necessary refueling infrastructure at no risk or expense to utility ratepayers.

Nevertheless, given the interest of some state-regulated gas utilities and their affiliates in developing NGV refueling stations, the challenge for public policymakers and regulators is to ensure a “level playing field” for non-utility enterprises and protect gas utility ratepayers, while focusing the activities of gas utilities in areas where they are best positioned to enable and facilitate growth in the use of natural gas as a transportation fuel. This can be accomplished if public policymakers and regulators adopt three broad policies.

First, state-regulated gas utilities should not be permitted to use ratepayer funds to finance the construction of refueling infrastructure except when such facilities are located on utility property and are needed to serve the utility’s fleet of natural gas vehicles. Any refueling services made available to the public at such facilities must be priced to recover the fully allocated cost of service that the utility incurs in providing these services.

Second, regulators must ensure a “level playing field” between unregulated gas utility affiliates and non-utility enterprises in developing refueling stations. Strong and enforceable codes of conduct or affiliate transaction rules will ensure that affiliates of gas utilities that engage in the NGV business face the same risk and reward terms and conditions as non-utility enterprises, and will not be accorded any preferential treatment by the gas utilities with which they are affiliated.

Third, to achieve the environmental and national security benefits of substituting natural gas-fueled vehicles for gasoline-and-diesel fueled vehicles, it is important that gas utilities focus their activities on promoting the growth of natural gas as a transportation fuel and developing the NGV market. This White Paper sets forth seven activities that policymakers, regulators, and natural gas utilities should consider to help develop the NGV market without harming the competitive development of NGV refueling stations.

II. Introduction

Natural gas is a proven vehicle fuel, yet the United States currently ranks 15th in NGV adoption worldwide, with NGVs accounting for only about 110,000 of the 250 million vehicles on its roads.¹ The majority of NGVs in the United States are local fleet vehicles that travel limited distances, but there is great and immediate potential for growth in the medium duty (“MD”) and heavy duty (“HD”) vehicle markets.²

In fact, the NGV market in the United States is poised to expand significantly. The price spread between gasoline and diesel, on the one hand, and natural gas, on the other hand, is reinvigorating the market. Domestic supplies of natural gas are plentiful, and are projected to last for more than 100 years at least, and those estimates continue to grow with advances in

¹ NGV Journal, *Worldwide NGV Statistics*, available at <http://www.ngvjournals.dreamhosters.com/en/statistics/item/911-worldwide-ngv-statistics>, last visited October 23, 2011; Ken Costello, *Natural Gas Vehicles: What State Public Utility Commissions Should Know and Ask*, at 19 (National Regulatory Research Institute, Briefing Paper, Dec. 2010). There are approximately 13.2 million NGVs operating outside the US. Joint Hearing on Energy Tax Policy and Tax Reform Before the Subcomm. on Select Revenue Measures and the Subcomm. on Oversight of the H. Comm. on Ways & Means, 112th Cong. 2 (2011) (statement of Andrew Littlefair, President & CEO, Clean Energy Fuels) [hereinafter “Littlefair Testimony”].

² These are classified by the U.S. Department of Transportation as Class 3 through Class 8 vehicles. *See* 49 C.F.R. § 565.15.

drilling technology.³ The prices for retail compressed natural gas (“CNG”) have been as much as \$2.00 per gasoline gallon equivalent (“GGE”) below gasoline and diesel prices.⁴ And the expectation is that the price spread will remain favorable for CNG.⁵ Liquefied natural gas (“LNG”) is also attractively priced.⁶

The heightening interest in NGVs is also driven by advancements in natural gas drilling and vehicle conversion technologies and the recognition that increased utilization of NGVs will decrease our dependence on foreign oil and reduce greenhouse gas emissions.⁷ In fact,

³ IHS CERA, Special Report, *Fueling North America’s Energy Future - The Unconventional Natural Gas Revolution and the Carbon Agenda*, at ES-4 (2010) (“North American discovered natural gas resources have increased by more than 1,800 trillion cubic feet (Tcf) over the past three years, bringing the total natural gas resource base to more than 3,000 Tcf, a level that could supply current consumption for well over 100 years.”); Press Release, Massachusetts Institute of Technology, *MIT Releases Major Report: The Future of Natural Gas* (June 25, 2010) (“The United States has a significant natural gas resource base, enough to equal about 92 years’ worth at present domestic consumption rates.”); Potential Gas Committee, PGC Press Release, *Potential Supply of Natural Gas in the United States* (PowerPoint, Apr. 27, 2011) (stating United States gas resources are at 1,897.8 trillion cubic feet (“Tcf”) and future gas supply is at 2,170.3 Tcf).

⁴ U.S. Department of Energy, *Clean Cities Alternative Fuel Price Report*, at 5-6 (July 2011).

⁵ U.S. Energy Information Administration, *Annual Energy Outlook 2010 With Projections to 2035*, at 38 (April 2010). See also Laurence Alexander et al., *Clean Technology - Natural Gas Vehicles: Building Momentum*, at 5 (Jefferies & Company, Inc., Report, Feb. 22, 2011) (“Based on EIA fuel price projections . . . the diesel vs. natural gas differential is forecast to more than double to roughly \$3.65/gal by 2025.”) [hereinafter “Jefferies Report”].

⁶ See Jefferies Report, *supra* note 5, at 18 (“Recent adopters of CNG and LNG engines have estimated that they can realize a 25% reduction in fuel costs by switching away from diesel engines.”); Clean Energy Fuels, *2010 Annual Report*, at 9 (showing representative annual per vehicle fuel cost savings for transit buses and refuse trucks using LNG in California during 2010 ranging from \$9,007 to \$12,121) [hereinafter “Clean Energy Annual Report”].

⁷ Costello, *supra* note 1, at iii (“New technologies for drilling shale gas, heightened recognition of natural gas’s smaller carbon footprint compared to gasoline and diesel oil, the motivation of gas utilities to increase profits through demand growth, and advances in transportation-oriented gas technology have all produced a renewed interest in . . . NGVs.”); Brent D. Yacobucci, *Natural Gas Passenger Vehicles: Availability, Cost, and Performance*, at 1 (Congressional Research Service, CRS Report for Congress, May 25, 2011) (“Congressional and consumer interest in passenger natural gas vehicles . . . has grown in recent years, especially in response to higher gasoline prices, concerns over the environmental impact of petroleum consumption for transportation, and policy proposals such as the ‘Pickens Plan.’”); Robert Zabors and Manisha Shah, *Is Now the Time for NGVs?*, AM. GAS, Aug./Sept. 2011, at 26-27 (“As an abundant domestic resource, natural gas promotes energy security, reducing our dependence on oil imports from politically unstable or hostile regions.”); *id.* at 28 (“Vehicle technology has improved and costs reduced through [original equipment manufacturer] cooperation with conversion system suppliers and component investments.”); U.S. Department of Energy, Alternative Fuels & Advanced Vehicles Data Center, available at http://www.afdc.energy.gov/afdc/vehicles/natural_gas_emissions.html (“Compared with (continued...)”).

according to the California Air Resources Board and other experts, NGVs produce 20 percent fewer greenhouse gas emissions, and 80 percent fewer ozone-forming emissions, than diesel and gasoline fueled vehicles.⁸

It is no surprise then that corporate and contract fleet operators in many major business sectors are transitioning their vehicles to run on clean-burning natural gas fuels.⁹ They are making the move because natural gas is a clean and cost effective transportation fuel that is commercially available today.¹⁰

In addition, moving America's heavy-duty truck fleet from diesel to natural gas is projected to have the effect of providing over 400,000 direct and indirect new jobs over the next five years through industries that manufacture natural gas fuel system hardware for vehicles, build and install hardware at fueling stations, and manufacture and construct production facilities for liquefied natural gas.¹¹

vehicles fueled with conventional diesel and gasoline, natural gas vehicles can produce significantly lower amounts of harmful emissions such as nitrogen oxides, particulate matter, and toxic and carcinogenic pollutants as well as the greenhouse gas carbon dioxide.”).

⁸ California Air Resources Board, *Drive Clean, Compressed Natural Gas (CNG)*, at http://www.driveclean.ca.gov/Search_and_Explore/Technologies_and_Fuel_Types/Compressed_Natural_Gas.php; Jefferies Report, *supra* note 5, at 1 (stating switching from diesel to natural gas vehicles can cut CO2 emissions by 20-25%, NOx emissions by more than 33%, and particulate emissions more than 50%); Costello, *supra* note 1, at 1 n.3 (stating NGVs emit about 25 percent less carbon dioxide than comparable gasoline-or-diesel fuel vehicles and produce about 80 percent fewer ozone-forming emissions).

⁹ See Clean Energy Annual Report, *supra* note 6, at 17 (describing a customer base that includes transit buses, taxis, shuttles and refuse trucks and explaining that customers are targeted “in a variety of markets, such as airports, public transit, refuse, seaports, regional trucking, taxis and government fleets”). See also Jefferies Report, *supra* note 5, at 7 (“The leading provider of natural gas . . . for transportation in North America is Clean Energy Fuels. It fuels a broad customer base in the refuse, transit, ports, shuttle, taxi, trucking, airport, and municipal fleet markets, fueling 20,000+ vehicles daily at 235 locations in the U.S. and Canada as of January 2011.”).

¹⁰ See Jefferies Report, *supra* note 5, at 18; Clean Energy Annual Report, *supra* note 6, at 9 (showing representative annual per vehicle fuel cost savings for natural gas vehicles for California during 2010 ranging from \$2,900 to \$14,122).

¹¹ Littlefair Testimony, *supra* note 1, at 3.

However, the continued growth of the NGV market in the United States depends heavily on developing a sufficient number of additional refueling stations. As discussed below, a number of non-utility, private enterprises have built and are operating NGV refueling stations and there are indications that these and other private enterprises will continue to enter and grow the market. Some regulated gas utilities have also expressed growing interest in serving the CNG refueling market in the United States. Faced with load erosion in their traditional markets, gas utilities in the United States are naturally interested in identifying and serving market segments which offer the promise of load growth. In fact, Atlanta Gas Light (“AGL”) and New Jersey Natural Gas have made regulatory proposals to enter the refueling market,¹² and there are reports that Piedmont Natural Gas has plans to make such a proposal.¹³ This poses a crucial policy issue: what, if any, is the appropriate role of state-regulated gas utilities in building refueling stations and providing related services?

III. There is no need for state-regulated utilities to build refueling stations to compete directly with stations owned by non-utility enterprises.

As a matter of long-standing policy in the United States, state-regulated utilities are called upon to provide a service when the market for that service exhibits the characteristics of a

¹² *In re Atlanta Gas Light Company’s 2011 Universal Service Fund Facilities Expansion Plan*, Proposed Compressed Natural Gas Fueling Infrastructure Investment Program, Docket No. 32499 (filed May 12, 2011); *In The Matter of the Petition of New Jersey Natural Gas Company for Approval of a Pilot Program for The Installation of Compressed Natural Gas Infrastructure and an Associated Recovery Mechanism with the Approval of Changes in the Company’s Tariff for Gas Service*, Petition of New Jersey Natural Gas Company for Approval of a Pilot Program for the Installation of Compressed Natural Gas Infrastructure and an Associated Recovery Mechanism with the Approval of Changes in the Company’s Tariff for Gas Service, Docket No. GR11060361 (filed June 16, 2011).

¹³ John Murawski, *Natural Gas Cars Get New N.C. Push - Piedmont Natural Gas and PSNC Energy Take Steps to Compete with Electric Vehicles*, CHARLOTTE OBSERVER, Aug. 17, 2011 (stating that Piedmont Natural Gas plans to add four or five more CNG pumping stations this year).

natural monopoly and cannot be competitive.¹⁴ The NGV refueling market does not have these characteristics. There is every indication that the NGV refueling market is and will remain competitive and will not require regulated utilities to build refueling stations and supply needed services. Hence, there is no need for regulated gas utilities to build refueling stations to compete with stations owned by non-utility enterprises. Nor is there any need for utilities to build stations to “jumpstart” the NGV refueling market.

Private non-utility enterprises have a strong business incentive to enter the NGV refueling market. The substantial price advantage of natural gas over gasoline and diesel as a transportation fuel provides the profit potential to attract private capital to develop NGVs and the necessary refueling stations.

In addition, there is no evidence that the NGV refueling market is a natural monopoly or otherwise not competitive. A simple analogy to the comparable gasoline refueling business, which is generally considered a competitive market, illustrates this point. Gasoline refueling markets are comprised of numerous small sellers that offer homogenous products. Numerous competitors in the markets and low barriers to entry prevent any one company from having substantial market power.

Moreover, there are competitive alternatives to natural gas as a transportation fuel. NGVs, gasoline-and-diesel fueled vehicles, and electric vehicles all compete against each other.

¹⁴ Bonbright et al., *PRINCIPLES OF PUBLIC UTILITY RATES* 17 (2d ed. 1988)(“Public utility regulation, if chosen in preference to outright public ownership, is therefore thought, or at least hoped, to be a substitute for competition.”). *See also* Jonathan Lesser & Leonardo Giacchino, *FUNDAMENTALS OF ENERGY REGULATION* 38 (2007) (“If a firm is a natural monopoly, or if a market is not workably competitive, a key goal of economic regulation is to prevent market power abuse either by restructuring the market to make it competitive or by regulating firms’ behavior.”); Joseph P. Tomain & Richard Cudahy, *ENERGY LAW IN A NUTSHELL* 42 (2d ed. 2011) (explaining that in monopoly markets regulation is needed to set prices at competitive levels).

Such competition will discipline price in all aspects of vehicle ownership and operation, including refueling. Entry and prices do not need to be regulated.

Finally, the availability of private, non-utility capital is sufficient to finance the expansion of NGV refueling infrastructure without regulated utility participation. Numerous natural gas fuel providers and station operators in the unregulated private sector are already actively working in a variety of roles to provide the refueling infrastructure. These companies, and some of their notable activities, include:

- Allsup Corporation
 - *CNG Station Owner/Operator*
 - *Has built 18 CNG refueling facilities and designed 15 facilities*¹⁵
- Applied LNG Technologies, LLC (“ALT”)
 - *LNG Plant Owner: LNG Fuel Provider*
 - *Produces, distributes, and sells LNG to transportation, industrial, and municipal markets in the western United States and northern Mexico*¹⁷
- AVSG LP
 - *CNG Station Network Owner/Operator*
 - *Owns and operates 12 CNG fueling stations in New England*¹⁹
- Mansfield Gas Equipment System, Inc.
 - *CNG Station Supplier/Owner/Operator*
 - *Engineered, supplied, constructed and maintained more than 150 CNG fueling station projects*¹⁶
- NorthStar, Inc. (wholly owned subsidiary of Clean Energy Fuels)
 - *LNG Station Provider/Operator*
 - *Has completed several installation and refurbishment projects*¹⁸
- OnCue Express
 - *CNG Network Owner/Operator*
 - *Operates 4 CNG Refueling Stations*²⁰

¹⁵ <http://www.allsupcng.com/>.

¹⁶ http://www.cngfuelsystems.com/index.php?option=com_content&view=article&id=53&Itemid=121.

¹⁷ <http://altlng.com/>.

¹⁸ http://www.northstarlng.com/Updates/NS_PROJS_History_JULY_2008.pdf.

¹⁹ <http://www.avsglp.com/about-us.html>.

²⁰ <http://www.oncueexpress.com/featureListings.asp>.

- CH4 Energy Corporation
 - LNG Station Owner/Operator
 - Provided LNG storage tank to Utah's first LNG Station²¹
- Chart Industries, Inc.
 - LNG Equipment Provider, Station Installer
 - Has equipment installed in over 90% of LNG fuel stations throughout the world²²
- Clean Energy Fuels
 - CNG, LNG Fuel Provider – Station Network Owner/Operator
 - Owns and Operates approximately 250 refueling stations across U.S. and Canada and 2 LNG plants²⁴
- CN Gas Group Corp.
 - CNG Equipment & Stations/US Agira Representative
- Petrocard Systems
 - Cardlock Operator, WM Retailer Producer/Kentucky
 - Operates Waste Management Refueling Station in Camden, NJ (see below)
- Pinnacle CNG Systems
 - CNG – Station Owner/Operator
 - Owns/Operates 16 stations²³
 - Part of Integrys Energy Group
- Trillium USA
 - CNG: Fuel Station Owner/Operator
 - Owns/Operates 4 CNG stations²⁵
 - Part of Integrys Energy Group
- Prometheus Energy Company
 - LNG Fuel Provider: LNG Supply

²¹ PR Newswire, Press Release, Utah Clean Cities Coalition, *Utah's First LNG Station Nears Completion* (Jan. 5, 2011).

²² <http://www.chartlng.com/customers.html>.

²³ http://www.pinnaclecng.com/fuel_sites/default.html.

²⁴ See Clean Energy Annual Report, *supra* note 6, at 122.

²⁵ <http://www.trilliumusa.com/pricing.php>.

- Encana Corporation
 - CNG & LNG Station Owner
 - Built one refueling station; 4 others in development²⁶
- Enviro Express Natural Gas LLC
 - LNG Station Owner/Truck Operator
 - Opened First LNG fueling center east of Mississippi River; facility also provides CNG fuel²⁸
- Go Natural Gas, Inc.
 - CNG Station Owner/Operator
 - Opened one refueling station; four others planned³⁰
- General Physics Corporation
 - LNG Equipment Provider, Station Installer, Operator
 - Constructed LNG fuel stations since 2000³²
- Linde
 - LNG Fuel Provider, Equipment Supplier
 - Owns and operates over 1,000 LNG plants³⁴
- Republic Services
 - CNG Station Owner/Operator
 - Opened \$3 million CNG station in Denver²⁷
- Speedy Fuels, Inc.
 - LNG Station Owner/Operator
 - Opened full service LNG station in Ports of Los Angeles & Long Beach²⁹
- Vocational Energy
 - CNG Station Provider: Refuse
 - Experience planning and constructing over 50 CNG stations since 2002³¹
- Waste Management, Inc.
 - Public Access Station Owner
 - Opened its first public-access CNG fueling station in Camden, NJ in June 2011³³
- Wisegas, Inc.
 - CNG Station Owner/Operator
 - Opened South Florida's first public access CNG station³⁵

²⁶ Encana Corporation, *2010 Annual Report*, at 6.

²⁷ Allan Gerlat, WasteAge, *Republic Opens New CNG Refueling Facility in Denver Area*, Sep. 22, 2011.

²⁸ <http://www.ct-futurefuels.com/FLEETS/EnviroExpress.html>.

²⁹ LNG World News, *Applied LNG Technologies Provides LNG to Speedy Fuels in Ports of Los Angeles and Long Beach*, June 18, 2010, available at <http://www.lngworldnews.com/applied-lng-technologies-provides-lng-to-speedy-fuel-in-the-ports-of-los-angeles-long-beach/>.

³⁰ http://gonaturalgas.com/index.php?option=com_content&view=article&id=30&Itemid=42.

³¹ <http://vocationalenergy.com/CNG-Alternative-Energy-Fuel-Pages/about.htm>.

³² <http://altfuels.gpworldwide.com/lngLcngH.aspx>.

³³ Press Release, Waste Management, *Waste Management Opens First Public Compressed Natural Gas (CNG) Fueling Station in Camden* (June 8, 2011).

- Zeit Energy
 - CNG Station Owner/Operator
 - Serves municipal and private fleet customers³⁶

These and other non-utility enterprises with sufficient capital are currently ready, willing, and able to meet the need for NGV refueling stations. For example, Clean Energy Fuels, an LNG/NGV fuel provider and refueling station owner and operator, recently received a \$150 million investment from Chesapeake Energy Corp. (“Chesapeake”)³⁷ and another \$150 million investment from an investment group.³⁸ Chesapeake estimates that about 1,000 stations are necessary for a reliable national grid for long haul trucking, and its investment in Clean Energy Fuels will support up to 150 of those needed stations.³⁹ Other gas producers that are also investing in refueling stations include Encana and Apache.⁴⁰ Encana built its first natural gas fueling station in Red River Parish, Louisiana in 2010, and already has four others in development.⁴¹ At year-end 2010, Apache reported that it had seven CNG stations.⁴² Thus, non-

³⁴ http://www.aga.is/international/web/lg/us/likeIgus30.nsf/docbyalias/nav_energy_ing.

³⁵ <http://www.wisegasinc.com/wg-first%20cng%20station.htm>.

³⁶ <http://zeitenergy.com/>.

³⁷ Press Release, Clean Energy Fuels Corp., *Chesapeake Energy to Invest \$150 Million in Clean Energy* (July 11, 2011).

³⁸ The group is comprised of Springleaf Investments Pte. Ltd., a wholly-owned subsidiary of Temasek Holdings Pte. Ltd., Lionfish Investments Pte Ltd, an investment vehicle managed by Seatown Holdings International Pte. Ltd, and Greenwich Asset Holding Ltd, a wholly-owned subsidiary of RRJ Capital Master Fund I, L.P. Press Release, Clean Energy Fuels Corp., *Three Global Investors to Invest \$150 Million in Clean Energy* (Aug. 25, 2011).

³⁹ Press Release, Platts, *Fueling Stations Key for U.S. Shift to Natural Gas-Powered Vehicles, Chesapeake Energy CEO Tells Platts Energy Week* (July 18, 2011) (stating that Aubrey McClendon, CEO Chesapeake Energy, said that the United States would need about 1,000 CNG and LNG stations to form a “reliable national grid” for gas-powered vehicles across the interstate highway system).

⁴⁰ See *infra* notes 41-42 and accompanying text. See also Jefferies Report, *supra* note 5, at 32.

⁴¹ Encana Corporation, *2010 Annual Report*, at 6.

⁴² Apache Corporation, *2010 Summary Annual Report*, at 8.

utility capital is leading the way in NGV market and infrastructure development, and there is no need for state-regulated gas utilities to use ratepayer funds to build refueling stations to compete directly with non-utility stations.

IV. Market distortions and unfair competition likely will result if state-regulated gas utilities build refueling stations.

Not only are NGV refueling stations built by state-regulated utilities not needed, but market distortions and unfair competition typically result when regulated utilities are permitted to serve competitive markets.

For instance, historically, some regulated natural gas utilities that owned NGV refueling stations charged below-cost prices for services under their rate schedules.⁴³ In such circumstances, where retail refueling rates associated with utility-owned stations do not recover the full cost of building and operating those stations, the resulting revenue shortfalls are often recovered through cross-subsidies from the utility's captive customers. This below-cost pricing is inherently anti-competitive and unfair, and can impair market development. Non-utility enterprises will find it hard to discount their prices enough to compete because their shareholders must bear the resulting revenue shortfalls. As a result, non-utility enterprises may be deterred from entering the NGV refueling market.

Market distortions and unfair competition also occur because regulated utilities are generally entitled to collect sufficient revenues in rates to recover not only their costs, but also an authorized return on their investment in rate base to provide monopoly services. Such full cost

⁴³ See, e.g., *Re Utility Involvement in the Market for Low-Emission Vehicles*, Decision, D.95-11-035, 165 P.U.R.4th 503, 1995 WL 768974 (CPUC 1995) [hereinafter "D.95-11-035"] (findings of fact 98-99 state that PG&E's "natural gas vehicle rate schedules reflect below-cost pricing because they do not recover any portion of PG&E's capital outlay, maintenance costs, or fuel taxes related to supplying natural gas as a vehicle fuel" and that SDG&E's rate schedules are similar in design).

recovery reduces the pressure to keep costs down through good management and innovation. As a result, prices in the market may be higher than they should be and utility ratepayers are forced to bear the high costs of uneconomic utility refueling stations.

Utility ratepayers also bear the loss of poorly performing refueling stations when utilities exit the business. Such “stranded” investments can be extremely costly for ratepayers. For example, Southern California Gas Company (“SoCalGas”) spent approximately \$40 million on stations in the 1990s which were sold for about \$2.7 million not long after they were built.⁴⁴

In contrast, non-utility enterprises that are operating in a competitive market cannot afford to build uneconomic refueling stations because they do not have captive customers that will foot the bill for revenue shortfalls. Instead, their shareholders, rather than utility ratepayers, properly bear the financial risk of any uneconomic stations and the cost of any stranded investment.

V. Regulatory policy considerations

Although state-regulated gas utilities do not need to build refueling stations to support the growing NGV market, and their involvement is likely to cause market distortions and unfair competition, some gas utilities nevertheless propose to enter the NGV refueling market. Given such proposals, the challenge for public policy makers and regulators is how to ensure a “level playing field” for non-utility enterprises and protect gas utility ratepayers, while focusing the activities of gas utilities in areas where they are best positioned to facilitate growth in the use of natural gas as a transportation fuel. Three broad policies to further these objectives are discussed below.

⁴⁴ Interview with Warren I. Mitchell, former President of Southern California Gas Company.

A. *Utilities should not be permitted to use ratepayer funds to compete with non-utility enterprises in the refueling market.*

As a general principle, state-regulated gas utilities should not be permitted to use ratepayer funds to finance the construction and operation of NGV refueling infrastructure to compete with private, non-utility enterprises. For the reasons discussed earlier, the use of ratepayer funds to finance NGV refueling infrastructure and engage in activities that should be provided in a competitive market can result in unfair competition and market distortions that are highly inefficient.

One exception to this general policy is refueling facilities located on gas utility property that are needed to serve the utility's fleet of natural gas vehicles. As a means of promoting the development of NGVs, public access to refueling services provided from such facilities may be allowed by regulators, but such services should be priced to recover the fully allocated cost of service that the utility incurs so that non-utility enterprises can compete.

The California Public Utilities Commission ("CPUC") has essentially adopted this policy. Legislation passed in California in the 1990s permitted the CPUC to authorize utilities to construct and maintain natural gas refueling stations and to recover through rates the costs associated with these projects, so long as the projects were in the ratepayers' long-term interests and did not allow utilities to compete unfairly with non-utility enterprises.⁴⁵ By 1995, the CPUC concluded that there were "many companies that are interested in competing in the market for the construction and operation of refueling stations at customer and other private sites" and that utility refueling station programs "must be designed to avoid giving the utility any market

⁴⁵ See *California CNG, Inc. v. So. Cal. Gas Co.*, 96 F.3d 1193, 1196-97 (9th Cir. 1997) (quoting Cal. Pub. Util. Code § 745.5 (a), (d)-(e)).

advantage, based on its monopoly status.”⁴⁶ The CPUC prohibited ratepayer funds from being used to subsidize the cost of refueling stations or the prices charged to purchasers of services from such stations.

Today, the CPUC continues to recognize the importance of ensuring that utilities are not allowed to compete unfairly with non-utility enterprises in competitive transportation markets. For instance, the CPUC recently has precluded electric utilities from competing with non-utility enterprises to provide the electric vehicle service equipment (“EVSE”) needs of electric vehicle owners.⁴⁷ The CPUC has essentially determined that this prohibition is necessary to help facilitate the development of the robust, competitive EVSE market necessary for electric vehicles to achieve their full potential in California, and that allowing utilities to compete in this market will be a hindrance. For the Commission to reconsider the prohibition, the utilities must demonstrate the presence of underserved markets or market failures in areas where utility involvement is prohibited.⁴⁸

B. Utility involvement in the refueling business is not necessary to “jumpstart” the market.

As noted earlier, there is no reason to think that gas utilities are needed to “jumpstart” the NGV refueling market. As explained above, below-cost pricing and other factors will actually discourage the entry of non-utility enterprises into the refueling market. As a result, fewer stations are likely to be built, not more.

⁴⁶ D.95-11-035, *supra* note 43, at *43.

⁴⁷ *Order Instituting Rulemaking on the Commission’s Own Motion to Consider Alternative-Fueled Vehicle Tariffs, Infrastructure and Policies to Support California’s Greenhouse Gas Emissions Reduction Goals*, Phase 2 Decision Establishing Policies to Overcome Barriers to Electric Vehicle Deployment and Complying with Public Utilities Code Section 740.2, D.11-07-029, Rulemaking 09-08-009 at § 7. (CPUC 2011).

⁴⁸ *Id.*

Moreover, there is no reason to think gas utilities are able to jumpstart the market. Many utilities were unsuccessful in the NGV refueling market in the past 15 years, including SoCalGas, Long Beach Gas, Public Service Company of New Mexico, and Public Service Company of Colorado. In addition, Atlanta Gas Light closed all public utility stations after the 1996 Summer Olympic Games.⁴⁹ Both Washington Gas and Columbia Gas also closed all of their facilities.⁵⁰

In many cases, these utility programs failed because they were uneconomic.⁵¹ The demand for their services did not materialize, in part because gasoline enjoyed a price advantage over natural gas⁵² and regulators acted to prevent cross-subsidization.⁵³ In addition, it became clear that operating refueling stations was an activity that fell outside the utilities' core competency (i.e., the distribution of natural gas) and that utilities lacked the skill set necessary to operate these stations efficiently.⁵⁴ These are additional reasons that undermine the premise that utility participation in the refueling business is necessary to "jumpstart" the refueling market, and they serve as reminders that ratepayer funds are at risk.

⁴⁹ An article in the *Atlanta Journal Constitution* noted that after deregulation AGL was not allowed to operate refueling stations, and that gas marketing companies would not make enough to justify their investment in the stations. Elyse Ashburn, *Atlanta's Interest Low in Alternative Fuels Despite Rise in Oil Prices*, ATLANTA JOURNAL AND CONSTITUTION, July 4, 2004.

⁵⁰ Interview with James N. Harger, Chief Marketing Officer, Clean Energy Fuels Corp. [hereinafter "Harger Interview"].

⁵¹ For instance, the Washington Utilities and Transportation Commission prohibited Puget Sound Energy from charging a compression fee, making its refueling stations uneconomic. *Id.*

⁵² *Id.*

⁵³ See D.95-11-035, *supra* note 43, at *43 (stating that utility refueling station programs must be designed to avoid giving utilities an unfair advantage based on monopoly status and that charges must be fully compensatory). See also *California CNG, Inc. v. So. Cal. Gas Co.*, 96 F.3d 1193, 1200 (9th Cir. 1997) (stating these portions of the CPUC's decision meant that "no ratepayer funds could be used to subsidize the utility's cost of fueling stations or the price it charged purchasers of such stations.").

⁵⁴ Harger Interview, *supra* note 50.

C. *There must be a “level playing field” between unregulated utility affiliates and non-utility enterprises.*

Even if regulators prohibit the regulated utilities from using ratepayer funds to build and operate NGV refueling stations, the holding companies that own those gas utilities may want to enter the market. Holding companies that own gas utilities should be allowed to develop NGV refueling stations only if regulators ensure a “level playing field” between utility affiliates and non-utility enterprises.

A gas utility has a clear incentive to help its affiliate get an unfair advantage over competitors in the refueling station market, and the ways it can do so are numerous and often subtle.⁵⁵ For example, a utility may attempt to use its assets to subsidize its unregulated affiliate in the refueling business and thereby shift the risk of participating in refueling from shareholders to utility ratepayers.⁵⁶ In transactions with its unregulated affiliate, it might seek to grant an undue preference or advantage or use ratepayer funds to subsidize the provision of goods or services to its unregulated affiliate.⁵⁷ The utility might try to provide an undue preference by sharing non-public information, or engaging in joint marketing arrangements or other activities,

⁵⁵ *Standards of Conduct for Transmission Providers*, Order No. 717, F.E.R.C. Stat. and Regs. ¶ 31,280, Regulations Preamble, 73 Fed. Reg. 63,796, at P 294 (2008) [hereinafter “Order No. 717”] (“There are potentially an infinite number of ways undue preferences might arise. . .”).

⁵⁶ Many states have established rules to prevent cross-subsidization in energy markets. *See, e.g.*, 16 TEX. ADMIN. CODE § 25.272 (“The provisions of this section establish safeguards to govern the interaction between utilities and their affiliates, both during the transition to and after the introduction of competition, to avoid potential market-power abuses and cross-subsidization between regulated and unregulated activities.”). *See also* Costello, *supra* note 1, at 6 n. 20 (noting that regulators may decide not to allow utility affiliates to participate in competitive markets because of the problems arising from a utility-affiliate relationship, including the pricing of affiliate transactions, cost shifting, cross-subsidization, and the discriminatory release of information from a utility to unregulated entities, among others).

⁵⁷ *See* Costello, *supra* note 1, at 6 n. 20. *See also* Order No. 717 at P 23 (“the core abuse to which the Standards are directed is that of undue preference in favor of an affiliate.”).

with its unregulated affiliate.⁵⁸ These types of activities give the unregulated utility affiliate an unwarranted and anti-competitive advantage over unaffiliated enterprises in the refueling business.

Thus, if regulators permit unregulated utility affiliates to develop NGV refueling stations, regulators must establish strong and enforceable codes of conduct, or strict affiliate transaction rules,⁵⁹ to ensure that unregulated affiliates face the same risk and reward conditions as non-utility enterprises and are not accorded any preferential treatment.

D. Policymakers, regulators, and gas utilities should consider certain activities that could develop the NGV market.

As explained above, gas utilities should not use ratepayer funds to build or operate NGV refueling stations to compete directly with non-utility stations. However, given the public policy benefits of NGVs to reduce both greenhouse gas emissions and our dependence on foreign sources of oil, it would be appropriate for utilities to promote the development of NGVs in certain ways to help realize those benefits. Set forth below are seven activities that policymakers, regulators and gas utilities should consider pursuing that could help develop the NGV market without harming the competitive development of NGV refueling stations.

⁵⁸ See Costello, *supra* note 1, at 6 n. 20. Preventing undue preferences arising out of the sharing of non-public information is a fundamental component of the Federal Energy Regulatory Commission's ("FERC") Standards of Conduct. FERC's no-conduit rule prohibits transmission providers from disclosing information to marketing employees. 18 C.F.R. § 358.6. The Commission has stated that its no conduit rule is critical to its regulatory scheme. Order No. 717 at P 198.

⁵⁹ Federal and state regulators overseeing competitive natural gas and electricity markets have for decades relied on strict standards or codes of conduct and affiliate transaction rules to prevent undue discrimination and unfair competition that can arise from the relationship between a regulated utility and its unregulated affiliate. See Order No. 717; See, e.g., *Codes of Conduct Governing Competitive Market Developments in the Energy Industry: An Analysis of Regulatory Actions*, White Paper (National Association of Regulatory Utility Commissioners) (Nov. 2000).

First, local distribution and transportation service to refueling stations should be provided at specific or dedicated NGV service rates rather than general service rates.⁶⁰ Dedicated rates should be based on the cost of delivering natural gas to these stations. Dedicated rates reflect the fact that CNG station load is not seasonal and, therefore, there is no need as with a general service rate to recover storage or peak natural gas pipeline capacity-related costs. Also, distribution service to NGV refueling stations should be provided at the highest pressure available. The higher the utility delivery pressure, the lower the compression costs are for refueling stations.

Second, gas utilities should allow public access to utility-owned refueling stations constructed to service their natural gas fleet vehicles. However, the rates charged to the public for refueling service from such facilities must recover the full cost of service. As discussed above, it is important to require utilities to recover the full cost of service so that non-utility enterprises are not disadvantaged and can compete.

Third, gas utilities should disseminate information about NGVs.⁶¹ Utilities often undertake customer information and outreach activities related to their core responsibilities and are well-situated to communicate with their customer base. Accordingly, utilities should consider advertising and providing information about the cost-saving, environmental, and energy security benefits of NGVs, and sponsoring fueling station maps. They should also consider

⁶⁰ See Costello, *supra* note 1, at 3, 5, 12 (stating that one role gas utilities could play in the development of the NGV market is to provide distribution service to refueling stations, and that utilities could offer discounted rates for NGV-related services, as well as other financial incentives and assistance).

⁶¹ See *id.* (identifying consumer education on the benefits of NGVs as another activity that gas utilities could undertake).

participating in national and state NGV organizations (e.g., NGV America and state NGV Coalitions).

Fourth, regulators should consider providing financial incentives to reward gas utilities (and their shareholders) for superior performance in facilitating NGV market development. For example, rate incentives could be targeted to increasing NGV system throughput and providing initial gas service to NGV customers in a timely way. In addition to helping achieve important public policy objectives, the increased gas throughput would help keep customer rates down. This would be especially beneficial to ratepayers of utilities that are otherwise facing load erosion.

Fifth, working with the American Gas Association or NGV America, gas utilities could aggregate orders for fleet vehicles and approach original equipment manufacturers (“OEM”s), such as General Motors, Ford, and Chrysler, for commitments to produce vehicles. They should maximize fleet purchases of alternative fuel vehicles and include MD and HD utility vehicles using CNG.⁶² Such a program will put more NGVs on the road and increase awareness of NGVs as an alternative to gasoline and diesel-fueled vehicles.

Sixth, gas utilities can purchase and offer demonstration NGVs for a limited time so that customers can evaluate them for possible fleet purchases. These demonstrations will also put more NGVs on the road and increase awareness of NGVs as an alternative to gasoline-fueled vehicles.

⁶² *See id.* (noting that gas utilities could purchase NGVs for their own fleets).

Finally, gas utilities can offer to finance home refueling appliances for residential customers for a limited period of time in order to help develop the market.⁶³ This portion of the NGV market is not yet competitive, and utilities can use their existing relationships with customers to increase residential use of NGVs and home refueling appliances.

VI. Conclusion

The use of natural gas as a transportation fuel is a rapidly growing market segment in the United States with substantial, untapped growth potential. The key factors driving this trend are the significant price advantage of natural gas as a vehicle fuel over gasoline and diesel fuels, an abundance of domestic natural gas supplies, an increasing awareness of the environmental benefits of using natural gas as a transportation fuel, and an enhanced recognition of the need to address the national security implications of our nation's excessive dependence on imported crude oil and petroleum transportation fuels.

Non-utility enterprises have access to sufficient capital and are prepared to build the infrastructure needed to support the growing NGV refueling market. There is no need for state-regulated gas utilities to build and operate NGV refueling stations to "jumpstart" this market. In fact, if gas utilities are allowed to use ratepayer funds to build refueling stations, the resulting market distortions and inefficiencies will place non-utility enterprises at a competitive disadvantage. In such circumstances, the refueling stations required to support the expanding NGV market may not be built, and those that are built will likely be at higher costs.

State regulators and policy makers should adopt common sense rules and policies to ensure that regulated gas utilities and their unregulated affiliates do not compete unfairly with

⁶³ *See id.* at 4 (stating that gas utilities might provide ratepayer-funded financial incentives for the purchase of home refueling appliances or offer discounts to customers who have NGVs).

non-utility enterprises. They should prohibit utilities from using ratepayer funds to compete, and enforce strong codes of conduct and affiliate transaction rules that prevent unregulated affiliates of gas utilities from enjoying an unfair advantage in the refueling market. They should encourage gas utilities to conduct activities that develop the NGV market without harming the competitive development of refueling stations. These policies will promote the development of the NGV refueling market and infrastructure needed to put more NGVs on the road, and will provide significant benefits to the American people.