Date of Hearing: July 1, 2024

ASSEMBLY COMMITTEE ON UTILITIES AND ENERGY
Cottie Petrie-Norris, Chair
SB 1221 (Min) – As Amended June 20, 2024

SENATE VOTE: 28-9

SUBJECT: Gas corporations: priority neighborhood decarbonization zones: pilot projects

SUMMARY: Authorizes limited and voluntary pilot projects to retire select portions of the natural gas utility system, so long as adequate substitute energy service is provided to customers within the pilot. Specifically, **this bill**:

1) Requires each gas corporation, on or before July 1, 2025, and annually thereafter, to file a map containing certain information, including the location of all potential gas distribution integrity management plan and other foreseeable gas distribution pipeline replacements. Directs the California Public Utilities Commission (CPUC) to determine whether gas corporations must continue this filing after January 1, 2030.

2) Requires the CPUC, on or before January 1, 2026, in a new or existing proceeding, to designate priority neighborhood decarbonization zones, doing so by considering factors such as the presence of disadvantaged or low-income communities in high-temperature climate zones, presence of environmental and social justice communities, supportive local governments, and the concentration of gas distribution line replacement projects.

3) Requires the CPUC, on or before July 1, 2026, in a new or existing proceeding, to establish a voluntary program to facilitate the cost-effective decarbonization of priority neighborhood decarbonization zones, not to exceed 30 pilot projects across the state and affecting no more than one percent of each of gas corporation's customers within their service territory. Specifies that projects where a gas corporation obtains 100% customer consent does not count toward the 30 pilot limit.

4) Requires the CPUC to establish the criteria and methodology for determining the cost-effectiveness of zero-emission alternatives, as defined, for purposes of the pilot projects; to determine the appropriate rate of return and recovery period that a gas corporation is eligible to receive for their costs to implement zero-emission alternatives for purposes of the pilot projects; and to establish how consent shall be given and project notifications delivered to affected customers.

5) Authorizes a gas corporation to cease providing service in an area within its service territory where a pilot project has been implemented if the CPUC determines that adequate substitute energy service is reasonably available to support the energy end use of affected gas corporation customers.

6) Repeals the above-described provisions on January 1, 2031.

7) Require the CPUC to submit various reports to the relevant committees of the Legislature regarding the pilot projects, as provided.

EXISTING LAW:

1) Requires every public utility to furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities, …as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public. This is commonly referred to as the utility's "obligation to serve." (Public Utilities Code § 451)

2) Authorizes the CPUC to supervise and regulate every public utility in the State and do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction. (Public Utilities Code § 701)

3) Authorizes the CPUC after hearing to ascertain and fix just and reasonable standards, classifications, regulations, practices, measurements, or services to be furnished, imposed, observed and followed by all electrical, gas, and water corporations. (Public Utilities Code § 770)

4) Requires the CPUC to require each gas corporation to provide bundled basic gas service to all core customers in its service territory unless the customer chooses or contracts to have natural gas purchased and supplied by another entity. (Public Utilities Code § 328.2)

5) Prohibits gas and electrical corporations from terminating residential service for nonpayment of a delinquent account unless the corporation first gives notice of the delinquency and impending termination, as provided in the statute. Prohibits disconnection of service due to nonpayment to a customer or if a member of a customer's household is under hospice care at home or depends on life-support equipment, and on specified days. (Public Utilities Code §§ 779, 779.1, 779.2, 780)

6) Requires the CPUC to require each gas corporation to provide bundled basic gas service to all core customers in its service territory, unless the customer chooses or contracts to have natural gas purchased and supplied by another entity. (Public Utilities Code § 963)

FISCAL EFFECT: According to the Senate Committee on Appropriations, this bill may result in ongoing costs of about $1.5 million and one-time costs of about $843,000 to the CPUC to develop the pilots.

BACKGROUND:

Natural gas in California – Approximately 77% of California's homes receive natural gas utility service. This equates to roughly 11+ million households of a total of 14.5 million. Another 450,000 commercial customers and nearly 36,000 industrial customers receive gas service, based on the data (2021) from the Energy Information Administration. Southern California Gas (SoCal Gas) and Pacific Gas & Electric (PG&E) provide gas utility service to about 5.9 million and 4.5 million customer service connections, respectively, while San Diego Gas & Electric (SDG&E) provides service to over 800,000 customer service connections. A few additional smaller gas investor-owned utilities (IOUs) provide service, including Southwest Gas and West Coast Gas. Additionally, there are a few publicly owned gas utilities (POUs), including the City of Coalinga, Long Beach Gas & Oil, City of Palo Alto, City of Susanville, and City of Vernon. These gas POUs are not regulated by the CPUC.

The state's natural gas utilities operate over 100,000 miles of transmission and distribution pipelines, including what is referred to as the "back-bone" system, and thousands more miles of service lines. According to a 2021 CPUC Staff Proposal, most gas used by the residential sector is for space and water heating, with smaller percentages used for cooking, fireplaces, clothes drying, and a few other functions. Dual fuel homes – those using both gas and electricity – are the dominant type of home in California. California is the state with the highest percentage of households using natural gas for cooking (70%).[1]

Cleaning Up Buildings – California's agencies are taking steps toward achieving carbon neutrality by 2045 and meeting the state's ambitious 2030 GHG emissions reduction target, including with actions specific to reducing emissions from the building sector. Residential and commercial buildings are responsible for roughly 25% of California's greenhouse gas (GHG) emissions when accounting for electricity demand, fossil fuels consumed onsite, and refrigerants, according to California Air Resources Board (CARB). Of the 25%, roughly 10% of emissions are attributable to fossil fuel combustion, including natural gas, with residential buildings accounting for slightly more of those emissions than commercial buildings. However, CARB has noted that these emissions numbers can vary from year-to-year. There are several strategies that can be employed to reduce GHG emissions from the building sector, these include: improved energy efficiency of buildings and appliances, reducing carbon emissions from fossil fuel sources, ensuring cleaner sources of energy to operate buildings and associated appliances, addressing methane leaks, and others.

Local Efforts on Natural Gas Moratoriums – In 2019, the City of Berkeley adopted the nation's first ban of natural gas hookups in most new residences and commercial buildings. Since then, about 50 other California cities and counties have adopted reach codes (those that surpass state building standards) or ordinances that either limit or ban the installation of gas connections to new buildings. Additionally, the Bay Area Air Quality Management District adopted rules prohibiting installation of natural gas furnaces and water heaters in residential and commercial settings beginning in 2027.

However, in April 2023, a federal court overturned the City of Berkeley's ban on natural gas hookups. The California Restaurant Association filed suit against the City of Berkeley months after the city adopted the ban. The Restaurant Association explains in its complaint that restaurants rely on natural gas for preparing certain foods, with many chefs trained only on natural gas stoves. The 9th U.S. Circuit Court of Appeals found the ban to be in direct violation of the Energy Policy and Conservation Act of 1975 (EPCA)[2]. In early January, a federal appeals court declined to rehear the earlier court decision striking down the City's ordinance. In late March, the City of Berkeley announced it is repealing the ordinance, which may take several months, so it is immediately ceasing enforcement of the ordinance in order to comply with the court ruling.

Obligation to serve – Under the "regulatory compact" a utility is granted an exclusive service territory (franchise), in exchange for accepting the responsibility to serve everyone in that territory and submit to rate-regulation by an economic regulator (a public utilities commission) where the utility has the opportunity to earn a rate of return. This acceptance of serving everyone

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[1] U.S. Energy Information Administration; "In 2020, most U.S. households prepared at least one hot meal a day at home." https://www.eia.gov/todayinenergy/detail.php?id=53439

[2] *California Restaurant Association v. City of Berkeley (United States Court of Appeals, 9th Cir. 2023*

in the territory is known as the utility's obligation to serve. The obligation to serve is articulated in various Constitutional provisions, CPUC decisions, and statutes; most notably, in Public Utilities Code § 451 which requires utilities "to furnish and maintain… adequate, efficient, just, and reasonable service." A number of statutes also provide requirements for how a utility must discontinue service, including provisions related to nonpayment by a customer. The obligation to serve applies to both gas and electric service within a given boundary, even when a single utility – such as PG&E – offers both. In other words, the obligation to serve – at least as currently applied – compels offerings of both electric and gas service to customers, even if a customer's full energy needs could be met by only one resource.

COMMENTS:

1) *Author's Statement.* According to the author, "Currently, long-term investments in new gas infrastructure occur in the short-term period of CPUC rate cases. This process does not allow for meaningful consideration of alternatives to new long-term capital investments in the gas system. Instead, dollar amounts are approved for spending categories, such as pipeline replacements that may cost over $3 million per mile. These decisions commit California's ratepayers to decades of expensive investments to delivery systems that may be obsolete before they are paid off. At a time of sky-high utility bills, zero-emission alternative projects would save ratepayers money as these projects are often less expensive than pipeline replacement projects. SB 1221 requires the CPUC to evaluate zero-emission alternatives to gas pipeline replacement projects, and encourages utility companies to pursue cost-effective, zero-emission alternative pilot projects. It will better inform the CPUC's Long-Term Gas Planning Rulemaking, while saving ratepayers money and reducing emissions from buildings."

2) *Balancing Customer Impacts.* Electrification has been promoted as one of the primary strategies for California to achieve its clean energy and GHG reduction goals, especially in applications powered by natural gas, such as in buildings. Aside from local efforts at natural gas moratoriums, as mentioned earlier, the approach to date to switch from natural gas to electricity in the building sector has lacked uniformity, instead relying on individual choice or individual financial incentives to encourage adoption. The consequence of such an approach is the potential for existing infrastructure to become stranded if the consumption of natural gas declines rapidly. This may leave an ever-shrinking portion of ratepayers having to bear the cost of maintaining a system built for a much larger customer pool, likely disproportionately impacting ratepayers least able to transition off of gas.[3] Some have hypothesized that this shrinking could trigger a feedback effect, where rising gas rates caused by electrification and falling demand can spur additional electrification, further exacerbating the cost burden and potentially threatening the financial viability of the gas system.[4]

   Moreover, the upfront costs of replacing gas appliances with electric appliances – as well as upgrading electric panels or re-wiring a building – are likely to be cost-prohibitive for

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[3] L. Davis and C. Hausman, "Who Will Pay for Legacy Utility Costs?" *Energy Institute White Paper 317*, June 2021.
[4] Aas, D., Mahone, A., Subin, Z., MacKinnon, M., Lane, B., and Price, S. *The Challenge of Retail Gas in California's Low-Carbon Future: Technology Options, Customer Costs and Public Health Benefits of Reducing Natural Gas Use*. California Energy Commission. Publication Number: CEC-500-2019-055-F. April 15, 2020.

many Californians, especially those on fixed-incomes, renters, and those generally lower-income or with limited discretionary income. As a result, a piecemeal approach to electrification may doubly hurt these Californians who cannot electrify due to the added cost of appliance replacement, but then become subject to higher gas bills as a result of others leaving gas service.

As a result of this customer double-edged sword, many electrification proponents have begun advocating for zonal decarbonization, or branch pruning, as a possible avenue that could achieve greater levels of emissions reductions while protecting communities from spiraling utility costs.[5] However, there are currently multiple unknowns concerning execution of such a complex, long-term policy, requiring careful planning between local and state authorities, utilities, and community groups. Moreover, while utility bill costs may be better managed with such an approach, individuals may experience sudden, expensive costs to convert home appliances, or otherwise risk compromising their ability to cook or to heat their homes.

Given the limited, if non-existent, understanding of real-world impacts to Californians of wide-spread decommissioning of the natural gas utility system, this bill establishes pilot projects to provide learnings and greater understanding of challenges of such approaches. The CPUC would designate priority neighborhood decarbonization zones where the pilots may occur; and establish a voluntary program by January 1, 2026 to facilitate the cost-effective decarbonization of customers in these selected pilots. The bill limits the number of pilots to no more than 30, and requires that no more than 1% of each gas corporation's customers can be affected. (In other words, one cannot draw a circle around the entire Bay Area and designate that as one pilot area.) In addition, at least 2/3rds of customers within a proposed pilot must consent to the project. This pilot approach seeks to provide real-world understanding of decommissioning portions of the natural gas utility system, while managing customer impacts.

3) *Alignment with Ongoing Planning Efforts.* The CPUC has an active proceeding related to long-term natural gas system planning where the core theme and many of the issues present in this bill are being discussed.[6] The CPUC has solicited comments from parties on a staff proposal to establish criteria and prioritize geographic areas of the gas system to identify the most cost-effective areas to decommission, including those where the environmental burdens may be highest. Separately, PG&E has submitted an application to pilot a zonal electrification project at California State University Monterey Bay.[7] The pilot would convert 391 of 484 services, including some student housing, to all-electric service instead of pursuing certain pipeline replacement projects previously planned for 2022-2025. PG&E characterizes the pilot as "first-of-its-kind," and estimates that the cost to gas customers to complete this alternative zonal electrification work will be less than the cost to replace the gas system, and requests authority to recover up to $22 million in program costs – including behind-the-meter costs – as regulatory assets.[8]

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[5] Ong, A., Mastrandrea, M., and Wara, M. *The Costs of Building Decarbonization Policy Proposals for California Natural Gas Ratepayers: Identifying Cost-effective Paths to a Zero Carbon Building Fleet*. Stanford Woods Institute Climate and Energy Policy Program White Paper. June 2021.
[6] R. 20-01-007
[7] A. 22-08-003
[8] A. 22-08-003; PG&E CSU Monterey Zonal Electrification Supplemental Amended Testimony; June 27, 2024.

It is currently unclear how many other locations might offer similar savings, willing participation, and benefits as PG&E's Monterey Bay project. This bill, and the pilots established therein, align with these efforts at the CPUC, and provide a limited sample size by which the CPUC can review the efficacy of zonal decarbonization, in order to evaluate customer impacts more fully. The bill also specifies that the pilots shall be "across the state," suggesting the potential for project selection to be diverse in geography and population. However, this bill does not make such diversity considerations a requirement of the designation of priority neighborhood decarbonization zones nor of preferencing pilot project. The author may wish to consider providing explicit direction in this bill that the 30 pilots are truly spread across the state and engage a variety of customer types (residential, renters, multi-meter, etc.), to provide as many use cases where zonal decarbonization may be studied.

4) *Determining Adequate Service.* This bill amends a utility obligation to serve in the areas where the pilot projects have been implemented. This revoking of the obligation to serve is dependent upon the CPUC determining that "adequate substitute energy service is reasonably available" to support the customers within the pilot zone. The bill goes on to note that the CPUC should adopt guidelines to aide in determining what is adequate substitute energy service, including ensuring that rates for the substitute service for low-income customers and renters are just and reasonable. This protection is important to center pilot selection on the impacts to individual affected customers, and not just whether the zonal decarbonization may be cost-effective for ratepayers collectively.

   However, this directive has raised concerns from parties. One, the Rural County Representatives of California writes in their Oppose letter that the guidelines shall ensure rates for substitute energy service should be just and reasonable for <u>all</u> customers, not just low-income and renters as called for under the bill. Two, the Clean Power Alliance community choice aggregator (CCA) raises in their Oppose Unless Amended letter jurisdictional concerns about requiring the CPUC to ensure "just and reasonable" rates for the substitute service. They note this language may grant the CPUC some degree of ratemaking authority over the CCAs, a fundamental concern for these energy providers, should a pilot be established within their service territory. The author may wish to consider amendments that address these concerns, while still maintaining the core direction to the CPUC that customers in these pilots will receive adequate service, including at reasonable costs, should they lose access to natural gas service.

5) *Sunsetting Challenges.* This bill provides a limited exception to a gas utility's obligation to serve, where they would be authorized by the CPUC to terminate service within the pilot project area if adequate substitute service is otherwise available. This lifting of the obligation to serve ensures these pilots are truly zonal decarbonization, such that an individual customer within the zone cannot request – and thereby receive – gas service, and thus binding the utility to the continued maintenance of the gas infrastructure serving that area.

   Yet this bill also repeals the statutory authorization of the pilots and the lifting of the obligation to serve on January 1, 2030. This repeal is important to ensure the Legislature is given an opportunity to review the efficacy of the pilot projects and whether they are meeting stated statutory goals, and to make any needed modifications or corrections to the program's structure. However, the consequence of such a repeal is that on January 2,

2030, customers within the pilot project areas could request new gas service and the utility would be obligated to provide it. This could change the economics and customer benefits of the pilots overnight. If the intention behind the statutory repeal is to allow time for a programmatic review, such an outright repeal may inadvertently undermine this effort. *As such, the committee recommends amendments to clarify the sunset applies to the CPUC's authority to establish new pilots, and does not impact pilots that were established prior to the repeal date; as well as clarify that the removal of the utility's obligation to serve is maintained in the pilot project areas that were authorized prior to the repeal date.*

6) *Which Customer Decides?* The gas utilities have raised implementation challenges regarding who will be consenting to the pilot projects. The bill currently requires consent of 67% of affected gas distribution customers. Though implied, this language is not explicit that these customers must be within the pilot project boundary. This requirement also becomes challenging with multi-unit buildings, such as apartments or mobilehome parks. Tenants in these circumstances may be individually metered, and thus a unique utility customer, but do not own the impacted residences nor even the appliances that would need replacement. It may be more appropriate in such circumstances that the customer responsible for the cost of conversion be the one consenting to the pilot. *The committee thus recommends amending the provisions related to customer consent to specify that it is the property owner with natural gas service within the pilot project boundary who will be consenting*. The author may wish to consider further clarification to ensure tenants receive, at minimum, adequate notification from property owners of the (pending or imminent) removal of appliances or other impacts to their residences should obligations under leases to provide such notice be insufficient.

7) *Previous Legislation.*

SB 527 (Min, 2023) would have required the CPUC, in consultation with gas corporations, to develop and supervise the administration of the Neighborhood Decarbonization Program to cease providing gas utility service in an area within its service territory if the CPUC determines that adequate substitute energy service is reasonably available to support the energy end use of affected gas customers. Status: *Held* – Senate Committee on Appropriations.

SB 48 (Becker) required the CEC along with other agencies, to develop to a state strategy to achieve State goals for energy and GHG emissions from existing buildings, and authorized the CEC to implement the strategy, upon appropriation, including authorizing establishing Building Performance Standards for existing commercial buildings to require reductions in energy usage and GHG emissions. Status: Chapter 378, Statutes of 2023.

AB 209 (Committee on Budget) among its many provisions, established the Equitable Building Decarbonization Program, including a direct install program to fund the installation of measures to reduce GHGs from buildings. Status: Chapter 251, Statutes of 2022.

AB 179 (Ting) Budget Act of 2022 appropriated $1.12 billion for the Equitable Building Decarbonization Program. Status: Chapter 249, Statutes of 2022

SB 1477 (Stern) required the CEC to develop a statewide market transformation initiative to transform the state's market for low-emission space and water heating equipment for new and existing residential and nonresidential buildings and to develop an incentive program to fund near-zero emission technology for new residential and commercial buildings. Status: Chapter 378, Statutes of 2018.

AB 3232 (Friedman) required the CEC to assess the potential for the state to achieve the goal of reducing the emissions of GHGs by the state's residential and commercial building stock by at least 40 percent below the 1990 levels by January 1, 2030. Status: Chapter 373, Statutes of 2018.

REGISTERED SUPPORT / OPPOSITION:

Support

350 Bay Area Action
Acterra: Action for A Healthy Planet
Activesgv
Advanced Energy United
Asian Pacific Environmental Network
Building Decarbonization Coalition
California Environmental Voters
Carbon Free Palo Alto
Carbon Free Silicon Valley
Carbon Zero Buildings INC
Ceres
Ceres, INC.
City of Oakland
Cleanearth4kids.org
Climate Action California
Communitiy Water Center
Earthjustice
Efficiency First California
Environmental Defense Fund
Green Building Architects
Marin Clean Energy (MCE)
Menlo Spark
NRDC
Quitcarbon
Redwood Energy
Rewiring America
Sierra Club California
Sierra Club of California
Silicon Valley Clean Energy

Sonoma Clean Power
Standearth
Stopwaste
Sustainable Silicon Valley
UndauntedK12
USGBC-LA
Vote Solar

Opposition

California Pool & Spa Association
Rural County Representatives of California (RCRC)

Oppose Unless Amended

Clean Power Alliance of Southern California
Southern California Gas Company

Other

California State Association of Electrical Workers
California State Pipe Trades Council
Coalition of California Utility Employees
Southern California Gas Company

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