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Decision 92-10-047 October 21, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

Application of PACIFIC GAS AND ELECTRIC COMPANY to guarantee certain financing arrangements to be entered into by Pacific Gas Transmission Company involving an aggregate principal amount not to exceed $751 million. (U39M)

Application 92-05-048
(Filed May 18, 1992)

(See Appendix A for appearances.)

INDEX

Subject ... Page

OPINION ... 2

1. Summary of Decision ... 2
2. Background ... 2
3. Motion of El Paso ... 5
4. Issues to be Resolved ... 6
5. Blanket Authority vs. Approval of a Specific Guarantee ... 8
6. Does the Proposed Authority Benefit PG&E and Its Ratepayers? ... 11
   - 6.1 Introduction ... 11
   - 6.2 Benefits of a $751 Million Guarantee ... 13
     - 6.2.1 Capital Cost Savings ... 14
     - 6.2.2 Will PGT Capital Cost Savings Benefit PG&E Ratepayers? ... 15
       - 6.2.2.1 FERC Approval ... 15
       - 6.2.2.2 Do Reduced PGT Rates Benefit PG&E Ratepayers? ... 16
       - 6.2.2.3 Allocation of Benefits to Classes of PG&E's Ratepayers ... 18
   - 6.3 Risks to Ratepayers ... 19
     - 6.3.1 Overall Risk ... 19
     - 6.3.2 Ratepayer Protection ... 20
   - 6.4 Alternatives to PG&E's Guarantee Proposal ... 23
   - 6.5 Conclusion ... 25
7. Consistency With "Market Forces" Policy ... 25

Findings of Fact ... 27
Conclusions of Law ... 30
ORDER ... 31

APPENDIX A

OPINION

1. Summary of Decision

We grant Pacific Gas & Electric Company (PG&E) authority under § 701.5 and § 830 of the Public Utilities Code[1] to guarantee debt of its wholly owned subsidiary Pacific Gas Transmission Company (PGT), in a principal amount not to exceed $751 million. We adopt several conditions to this grant which are designed to protect ratepayers from risk and to ensure that ratepayers benefit from financing cost savings that are associated with a guarantee of PGT debt.

2. Background

PGT currently owns and operates a 612-mile natural gas pipeline system from the international border near Kingsgate, British Columbia and through the states of Idaho, Washington and Oregon to a point of interconnection with PG&E's facilities at the California-Oregon border near Malin, Oregon. By this application, PG&E requests authority under § 701.5 and § 830 to guarantee the debt financing of the PGT segment of an expansion of PG&E's and PGT's Canada-to-California natural gas pipeline (Expansion Project or Project), as well as the authority to guarantee the debt refinancing of PGT's existing pipeline system.[2] PG&E asserts that its proposal will enable it to obtain the least-cost financing

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1 All statutory references in this opinion are to the Public Utilities Code unless specifically stated otherwise.

2 PG&E was granted a Certificate of Public Convenience and Necessity (CPCN) to construct the California segment of the Project pursuant to Decision (D.) 90-12-119. PGT was authorized by the Federal Energy Regulatory Commission (FERC) to construct and operate the interstate portion (Canadian border to California border) of the Project in August and October 1991. (56 FERC ¶ 61,192 and 57 FERC ¶ 61,097). According to PG&E and PGT, approximately one-half of the project had been completed as of the date of hearings in this proceeding. Expansion Project operations are scheduled to begin in November 1993 for both segments.

for the PGT segment of the Expansion Project as well as the existing PGT system, and that ultimately, these lower financing costs will be passed on to consumers through lower gas transportation charges.

Specifically, PG&E requests authority to unconditionally guarantee payment when due of a credit facility up to but not exceeding a principal of $751 million, together with all related interest, fees and other monetary obligations to lenders. As the application was originally filed, the amount of the credit facility had been calculated as follows:

	Millions
Budgeted cost of PGT's portion of the Expansion	$864.0
Less Expansion costs after December 31, 1993 to be financed by cash flows from operations scheduled to begin in November, 1993	(14.5)
	849.5
Times 70% for debt financing	x.70
	594.7
Lender-required project contingency fund of 10%	59.5
	654.2
Refinancing and capital improvements of PGT's existing system rate base as of December 31, 1993 (Projected 1993 year-end rate base of $155.8 million x 55% debt financing)	85.7
	739.9
Estimated Closing Costs at 1.5%	11.1
	$751.0

PG&E requests authority to have a guarantee in place for up to 12 years. PG&E also seeks adoption of its proposed mechanism (as revised at hearings) to protect ratepayers in the unlikely event of a payment under the guarantee.

Division of Ratepayer Advocates (DRA) and Toward Utility Rate Normalization (TURN) jointly filed a Protest to the application. El Paso Natural Gas Company (El Paso), a competing pipeline that transports domestic gas supplies to California, and Altamont Gas Transmission Company (Altamont), a proposed pipeline that might compete with the Expansion Project in transporting Canadian gas to California, each filed a protest. PG&E filed a Response to the Protests, arguing among other things that the protesting parties were using this financing application as a vehicle for an impermissible collateral attack on D.90-12-119, the Commission's decision granting PG&E a CPCN to construct the PG&E segment of the Expansion Project.

Following a prehearing conference held on August 14, 1992, an Administrative Law Judge's (ALJ) ruling of August 18, 1992, established an expedited schedule for evidentiary hearings and limited the scope of evidence to be heard. The ruling provided in pertinent part:

> "The immediate question to be determined in this docket is whether the Commission should authorize Pacific Gas and Electric Company to guarantee a financing arrangement for Pacific Gas Transmission Company (PGT). Whether construction of the PGT Expansion (or the related intrastate portion of the expansion) should proceed is not at issue here."

Parties were therefore directed to assume for purposes of this proceeding that the PGT Expansion Project will be built whether this application is granted or denied.

In addition to PG&E, PGT and Altamont were the only parties to sponsor prepared testimony. Other active parties, including DRA and TURN, El Paso, the State of New Mexico (New Mexico), and Pacific Interstate Transmission Company (PITCO), limited their participation to cross-examination of witnesses and briefing.

Hearings were held before ALJ Wetzell, on September 8, 9, and 10, 1992. The matter was submitted with the filing of concurrent briefs on September 21, 1992. The ALJ's proposed decision (PD) was filed and served on October 13, 1992. All parties have stipulated to a reduction of the 30-day period between issuance of the ALJ's proposed decision and issuance of the Commission's decision in accordance with § 311(d), which allows Commission consideration of the matter at its regularly scheduled meeting of October 21, 1992. In view of the possibility of rising interest rates, we conclude that there is good cause for the expedited schedule here, which provided for the filing of comments on October 19th, without the filing of reply comments. Prompt action should enable PG&E to take advantage of currently favorable interest rates.

Comments on the PD were submitted by PG&E and PGT, DRA and TURN, Altamont, El Paso, New Mexico and PITCO. We have reviewed these comments and incorporated appropriate changes in this decision. Among other things, we replace the PD's "reasonable likelihood" standard for determining utility and ratepayer benefits with a preponderance of the evidence standard. We also modify the PD's blanket authority by specifying in broad terms the uses which PGT may make of the loan proceeds.

3. Motion of El Paso

On September 22, 1992, El Paso filed a motion requesting permission to file its brief on that date, one day late. El Paso states that it encountered technical difficulties in the electronic transmission of it brief to its San Francisco office, preventing the filing of the brief with the Docket Office by September 21, the date set by ALJ ruling. El Paso states that it served its brief on other parties on September 21.

Good cause having been shown, we will grant El Paso's motion. No party is prejudiced by the delay in filing with the Docket Office, and the expedited processing of this application has not been materially affected. Accordingly, El Paso's brief is deemed to have been filed on September 21, 1992.

4. Issues to be Resolved

We affirm the ALJ's August 18 ruling limiting the scope of evidence to be heard. PG&E states that it will fulfill PGT's financing requirements with shareholder equity if its request is denied. For purposes of considering this financing application, it is neither necessary nor appropriate to consider issues raised by protestants which relate solely to the question of whether the PGT segment or the PG&E segment of the Expansion Project should be authorized or built.

This proceeding is governed by §§ 701.5 and 830. The latter section requires public utilities to secure Commission authority before they can "assume any obligation or liability as guarantor, endorser, surety, or otherwise in respect of the securities of any other person, firm, or corporation, when such securities are payable at periods of more than 12 months after the date thereof...." Section 701.5 generally prohibits Commission approval of affiliate/subsidiary financing by utilities such as PG&E with limited, specific exceptions. It provides:

> 701.5. With respect to financing arrangements which are established after January 1, 1988, no electrical, gas, or telephone corporation, whose rates are set by the commission on a cost-of-service basis, shall issue any bond, note, lien, guarantee, or indebtedness of any kind pledging the utility assets or credit for or on behalf of any subsidiary or affiliate of, or corporation holding a controlling interest in, the electrical, gas, or telephone corporation. The commission may, however, authorize an electrical, gas, or telephone corporation to issue any bond, note, lien, guarantee, or indebtedness pledging the utility assets or credits as follows:
>
> (a) For or on behalf of a subsidiary if its revenues and expenses are included by the commission in establishing rates for the electrical, gas, or telephone corporation.
>
> (b) For or on behalf of a subsidiary if it is engaged in a regulated public utility business in this state or in any other state.

(c) For or on behalf of a subsidiary or affiliate if it engages in activities which support the electric, gas, or telephone corporation in its operations or service, these activities are, or will be, regulated either by the commission or a comparable federal agency, and the issuance of the bond, note, lien, guarantee, or indebtedness is specifically approved in advance by the commission.

The commission shall not approve the bond, note, lien, guarantee, or indebtedness unless the commission finds and determines that the proposed financing will benefit the interests of the utility and its ratepayers. (Added Stats. 1987, Ch. 1179.)

PG&E seeks authority to provide a guarantee for or on behalf of PGT, a wholly owned subsidiary which engages in activities which support PG&E in its operations or service, and which activities are, or will be, regulated by FERC, a federal agency which is comparable to this Commission. The proposal thus falls squarely under the situation described in subdivision (c) of § 701.5 and is, therefore, eligible for an exception to § 701.5's general prohibition. However, the most significant requirement of § 701.5 in this case is that the Commission shall not approve PG&E's proposal unless it finds and determines that the guarantee will benefit PG&E and its ratepayers. Whether it does so is a threshold issue in this proceeding.

Another contested issue is whether this Commission's policy of relying on market forces, rather than traditional case-by-case determinations of public convenience and necessity, for determining state and federal pipeline capacity matters is contravened or thwarted by PG&E's proposed guarantee. We first consider the assertion of protestants that the Commission should not grant PG&E's request to guarantee PGT's financing because the terms and conditions of the agreement to be guaranteed have not been placed in the record.

5. Blanket Authority vs. Approval of a Specific Guarantee

The August 18 ALJ ruling provided that identification of the specific elements of the guaranteed financing arrangement is properly addressed as an issue in this proceeding. PG&E responded by including with its prepared testimony a detailed summary of the terms and conditions of a financing proposal which has been submitted to PG&E and PGT by a group of four banks.[3] PG&E presented a summary of this "bank group" proposal rather than the actual terms and conditions because negotiations are still under way. Some aspects of the financing proposal are considered by PG&E and the banks to be confidential.

At the hearings, PG&E's witness "clarified" the application by stating that PG&E is not seeking Commission authority for specific terms of a particular financing guarantee arrangement. Rather, PG&E seeks blanket authority to guarantee PGT's debt under any financing agreement which may be negotiated in the future, whether that agreement is with the group of four banks that PGT is now negotiating with or otherwise. PG&E seeks flexibility to negotiate specific terms and conditions of a guaranteed credit facility under broad authority without further Commission approval or review. The only qualifications which PG&E agrees to for purposes of this blanket authority are that the credit facility to be guaranteed should be for a principal amount of no more than $751 million and that the guarantee should remain in effect for no more than 12 years. The planned uses of the $751 million ($654.2 million for debt financing of the Expansion Project, $85.7 million for refinancing and capital improvements of

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3 Barclays Bank PLC, Canadian Imperial Bank of Commerce, First National Bank of Chicago, and Swiss Bank.

the existing PGT system, and $11.1 million for closing costs) are no longer conditions of the authority sought by PG&E.[4]

Thus, the bank group proposal is at best instructive in considering the nature of the actual agreement that PGT and its lenders, and PG&E as guarantor, may enter into if this application is granted. We cannot and do not rely on it as evidence of the specific proposal before us. The final terms and conditions of the credit facility to be guaranteed are unknown to us.

We can conclude from reviewing the record that it is likely that the final agreement will include in some form the following terms and conditions which must be fulfilled before PG&E is released from the guarantee obligations: (1) there is no litigation pending affecting the borrower which would materially and adversely affect its ability to service its debt; (2) all conditions have been satisfied for shippers representing the vast majority of the pipeline's capacity to begin paying demand charges or reservation fees; (3) all material regulatory approvals have been obtained and are final and not subject to appeal; and (4) the pipeline expansion has been completed in a manner satisfactory to the Independent Engineer consultant representing the banks. This is not an all-inclusive list of conditions but it is representative of typical lender requirements. Also, although we do not know the exact amounts of debt which will be issued under the guarantee or the exact uses thereof, it appears that even with blanket authority, the bulk of the guaranteed debt proceeds would be used

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4 PG&E originally applied for authority to pledge its assets or credits in connection with, and to assume the obligations and liabilities as guarantor under, the financing arrangements described in the application. (Application (A.) 92-05-048, pp. 21-22.) These "described financing arrangements" included the above-stated uses of the $751 million principal amount. PG&E's witness stated that PG&E does not now request any limits on the relative amounts which may be used for the expansion project or existing system. (Tr. 17.)

for capital expenditures for the PGT portion of the Expansion Project while a relatively small amount would be used for refinancing and capital expenditures for the existing PGT system. As we discuss below, we find it necessary to set certain broad limits on the uses of PGT's guaranteed debt as a condition of our approval of the application.

PG&E claims that its request for negotiating flexibility under blanket authority is consistent with the Commission's traditional approach to financing applications. PG&E points to a recent application (A.91-08-058) for approval of debt issuance and the Commission's decision granting that application (D.91-12-021) as typical of a "long-standing" Commission policy favoring grants of broad authority. PG&E argues that the ratepayer benefits which it believes will flow from a guarantee are not affected by the terms and conditions thereof. PGT echoes this contention, noting PG&E testimony that the "Commission routinely entrusts to PG&E's business judgment and negotiating acumen the detailed terms and conditions for utility debt undertakings much greater than the $751 million debt facility at issue here."

The opposing parties argue that a blanket guarantee authority is not permitted by § 701.5. They reason that since the terms and conditions are unknown, the Commission is unable to weigh the ratepayer risks and benefits. Altamont also believes that § 830 precludes a guarantee of PGT's obligations or liabilities when those obligations or liabilities are unknown to the Commission. Accordingly, the opponents generally argue that the application must be denied. El Paso alternatively recommends deferral of the application pending PG&E's submission of a filing that describes the final terms and conditions of an agreement.

El Paso points out that with blanket authority, PGT could incur debt for purposes which are presently unknown and which could impose high risks for ratepayers. For example, of the $85.7 million in guaranteed debt intended for the existing PGT system,

only $50.7 million will be used for refinancing of debt. PG&E's witness acknowledged that the remaining $35 million could be used for any of a variety of purposes, including unspecified ongoing capital spending, replacement of equity with debt, resolution of pending Canadian producer litigation, or FERC Order 636 transition costs. We share El Paso's concern. To provide assurance that ratepayer benefits are maximized and risks are minimized, we will limit PGT's use of the guaranteed debt to purposes stated by PG&E in its application, and further require that the majority of the borrowings be used for the Expansion Project. This approach will still provide PGT with flexibility in the exact allocation of the proceeds.

This is clearly not a routine financing matter, and the approach that we followed in A.91-08-058 is not determinative of the approach that we should take here. As already noted, we are required by § 701.5 to conduct a review under specific criteria which do not apply in most other financing cases. Nevertheless, we do not find that we are precluded by § 701.5 from considering the application on its merits. PG&E's choice to request blanket authority simply means that we must answer the following question in the affirmative to satisfy § 701.5: Will any credit facility which PG&E and PGT might negotiate with lenders, and implement in accordance with the blanket authority, provide a benefit to PG&E and its ratepayers? Similarly, we find nothing in § 830 which precludes a grant of blanket authority.

6. Does the Proposed Authority Benefit PG&E and Its Ratepayers?

6.1 Introduction

Under § 701.5 the Commission must find that PG&E's proposal <u>will</u> benefit the utility and its ratepayers before PG&E can be authorized to pledge its assets or credits. Since the

statute requires a forecast of future benefits, we find it necessary to establish a standard for determining when a financing arrangement will provide a benefit.

Uncertainty accompanies any forecast. We do not envision any situation where we would encounter a financing proposal which would, with complete certainty, provide a future benefit to utilities and ratepayers. Nor do we have reason to believe that the Legislature intended a standard of absolute certainty. Accordingly, we require the applicant to show by a preponderance of the evidence that the guarantee proposal will benefit the utility and its ratepayers. We believe such a showing meets the statutory requirement. Preponderance of the evidence means that the evidence in support of applicant's position, when weighed with that opposed to it, must have the more convincing force and the greater probability of truth. (1 Witkin, California Evidence (3d Ed. 1986) § 157.)

It is clear that there are both potential risks and benefits associated with PG&E's proposal. There are at least two potential risks for PG&E's ratepayers. First is the possibility that they will be liable for any payments made under a guarantee. The second is that, whether or not there are any payments, the operation of financial markets will cause PG&E's cost of capital to increase as a result of a guarantee's existence. PG&E maintains that it has removed these risks in the workings of its proposal, while other parties disagree with that contention. We discuss the questions of risk in a subsequent subsection. However, it is important to recognize that to the extent that there are any risks whatsoever, they must be balanced against the benefits flowing from a guarantee. Thus, in deciding this matter, we are ultimately

concerned with whether the guarantee proposal will yield net benefits for ratepayers.[5]

Finally, we note that § 701.5 requires that the benefits of the arrangement accrue to the utility as well as its ratepayers. We believe the statute prohibits approval of utility support for overly risky affiliate endeavors which jeopardize the utility's financial situation even if it can be shown that ratepayers would have some benefit. The statute clearly asks us to protect utilities from their own imprudent financial and investment decisions involving affiliates or subsidiaries. In this case, we believe that there is a persuasive showing that PG&E (and its shareholders) will benefit from guaranteeing its subsidiary's debt and taking advantage of lower-cost debt financing. Lower costs can only strengthen PGT as a competitor. The accompanying potential risks are minor and do not jeopardize PG&E's financial condition. Accordingly, we are satisfied that the primary focus of our determination is whether there are benefits for ratepayers.

<u>6.2 Benefits of a $751 Million Guarantee</u>

PG&E claims that with guaranteed debt financing, capital costs for the PGT system will be lower than they would be without a guarantee. This will assertedly yield lower transportation rates on the PGT system. According to PG&E, lower delivered Canadian gas costs will benefit PG&E's ratepayers through lower electric generation and gas service costs. Because PG&E's gas transmission

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5 We note that the Legislature used the criterion of "net benefits to ratepayers" in subdivision (b)(1) of § 854, a statute which governs utility acquisitions and mergers. We do not see any particular significance in the omission of "net" in § 701.5. To do so would be, in effect, to hold that any guarantee or other financing arrangement covered by § 701.5 is allowable, regardless of costs and risks, as long as there is a scintilla of benefit. We find it reasonable to interpret § 701.5 as requiring a net benefit after costs and risks have been considered.

customers will also be PGT's Expansion Project customers, these new PG&E ratepayers will allegedly benefit from reduced PGT transportation rates.

6.2.1 Capital Cost Savings

According to PG&E, third-party lenders are unwilling to provide funding to PGT without some form of guarantee. In the absence of a guarantee, PG&E asserts, the only funding source available to PGT is direct funding by the parent using PG&E shareholder equity funds. Those funds are now being loaned by PG&E to PGT at an interest cost equal to PG&E's 1992 authorized rate of return on equity, or 12.65%. By contrast, based on lending options available under the bank group proposal now being negotiated, PG&E estimates that guaranteed borrowing will be available at no more than 4.5%. Based on the difference between financing at 4.5% and 12.65%, PG&E calculates capital cost savings of $45.7 million for PGT Expansion Project funding and $7 million for existing system debt, or a total of $52.7 million.

PG&E acknowledges that the 4.5% estimate is subject to variation, although it is confident that 4.5% is a conservatively high rate for purposes of this application. Similarly, the PGT lending cost of 12.65% is subject to variation since it is based on PG&E's authorized return on equity, which is adjusted in annual proceedings. The estimate of $52.7 million is therefore subject to variation as well. PG&E's witness stated it could vary by 10%. However, PG&E asserts that regardless of the actual amount, significant savings will be realized with a guarantee because the cost of guaranteed debt financing will always be less than that of financing using PG&E equity-funded loans to PGT.

The evidence is persuasive that a loan guarantee such as that contemplated by PG&E will result in lower capital costs for the PGT system. Whether the actual savings will be $52.7 million or a lesser amount is open to question, but there is no reasonable question that guaranteed debt financing will result in lower costs

than continuation of the current equity-based financing. Moreover, as we discuss in a later subsection, there is no reason to believe that alternative financing having equivalent savings but without a guarantee would be available to PGT. We conclude that capital cost savings which are not otherwise available can be realized if PG&E is authorized to guarantee PGT's debt. The amount of savings is quite possibly less than $52.7 million and most of it (from reduced capital costs on the PGT Expansion Project) would be amortized over the 30-year life of the project, but it is still significant.

6.2.2 Will PGT Capital Cost Savings Benefit PG&E Ratepayers?

A number of conditions, listed below, must be met before PGT's capital cost savings can be translated into PG&E ratepayer benefits.

6.2.2.1 FERC Approval

As a FERC-regulated pipeline, PGT must file for a general rate case and seek approval of gas transportation rates which reflect its capital costs, among other things. For PG&E's estimated savings of $52.7 million to be translated into lower gas transmission rates, we must assume that in the absence of a guarantee FERC would approve rates which reflect a debt cost of 12.65%. We must also assume that with a guarantee FERC would approve rates which reflect a debt cost of 4.5%.

PGT is scheduled to file a general rate case in 1993 under the normal FERC three-year rate case cycle. Rates authorized by FERC in that case will probably become effective in January 1994. PG&E thus asserts that PGT transmission rates will flow through to PGT ratepayers the benefit of reduced capital costs beginning in 1994.

Altamont questions whether FERC would approve a debt cost as high as 12.65% when PGT's currently authorized debt cost is approximately 10%. PG&E on the other hand believes that PGT would be able to make a strong case before FERC that without a guarantee, the actual debt cost would be 12.65%. In any event, PG&E argues,

even if the capital cost reduction is based on the difference between 10% and 4.5%, it would still be significant.

We decline to speculate how FERC might respond to a PGT request for approval of debt financing at 12.65%. We acknowledge only a possibility that PGT could make a successful showing in support of debt costs based on PG&E equity costs. Thus, the amount of savings that might be acknowledged by FERC could be less than $52.7 million. Still, as noted above, we are left with persuasive evidence that the existence of a guarantee will lead to lower debt financing costs. We conclude that commencing in 1994, FERC-approved PGT transmission rates will be millions of dollars lower as a result of guaranteed debt than they would be in the absence of such a guarantee.

6.2.2.2 Do Reduced PGT Rates Benefit PG&E Ratepayers?

PG&E's demonstration of ratepayer benefits is based on the assumption that the effects of reduced PGT transportation rates will flow to PG&E's customers. Altamont and the other opponents of a guarantee point to the existence of netback pricing provisions in Canadian gas supply contracts, where the price received by the producer is based on a benchmark delivered California price net of transportation costs.[6] They argue that due to these netback

6 With respect to the existing PGT system, current contracts between PG&E and producers are based on netback provisions.

With respect to the expansion, contracts between Southern California Edison Company (Edison) and Canadian marketers and between San Diego Gas & Electric Company (SDG&E) and Canadian marketers include some netback provisions. Deliveries under these contracts may account for one-third of the capacity of the PG&E segment of the expansion.

However, it is clear that these are not simple netback contracts. Only a portion of the Edison contract volumes can be

(Footnote continues on next page)

contracts, any benefit resulting from reduced transportation rates on the PGT system will flow northward to Canadian producers rather than to PG&E ratepayers. PG&E responds that it is attempting to renegotiate its own existing supply contracts with the objective of eliminating netback provisions.

To the extent that gas moving over the existing system and the Expansion Project is priced under netback arrangements, any benefit of reduced PGT transportation rates will accrue largely to producers. This record does not allow us to determine with any precision what that extent is. It is apparent that netback provisions are prevalent for gas that now moves or will move over the PGT system, at least in the near future. It is also apparent that PG&E is intent on pursuing efforts to remove these provisions in its own supply contracts, although the chances for its success in those efforts are not assured.

In the short run, it seems likely that netback pricing will be an important but not exclusive part of the picture for gas moving on an expanded PGT system. Over time, we expect PG&E's efforts to eliminate netback pricing provisions to further diminish the extent to which netback pricing reduces PG&E ratepayer benefits. Moreover, as transportation costs are lowered on the PGT system due to lower capital costs, there also should be more aggressive competition resulting in lower gas costs to end users. Since the reduced transportation rates on the PGT system will be realized over a 30-year period, we find it reasonable to expect

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(Footnote continued from previous page)

considered as governed by netback pricing. Under the SDG&E contracts, to the extent that SDG&E does not take gas at a 100% load factor, SDG&E ratepayers are affected by transportation costs.

that, despite current netback provisions, PG&E ratepayers will benefit from those reduced rates over time.

In addition to the effects of netback pricing, we note that another diversion of the benefit of reduced transportation rates from PG&E ratepayers results from the fact that PGT is an interstate pipeline with customers other than PG&E. PITCO, the second-largest customer on the existing PGT system (after PG&E) ships approximately 240 million cubic feet (MMcf) per day on the PGT system. PITCO sells all of its gas supply to Southern California Gas Company. Also, 148 MMcf of daily capacity on the PGT Expansion Project is reserved for firm deliveries to the Pacific Northwest.

6.2.2.3 Allocation of Benefits to Classes of PG&E's Ratepayers

For purposes of this proceeding, PG&E's ratepayers include not only its traditional gas (core and noncore) and electric customers in Northern and Central California, but also Edison, SDG&E, and other shippers that have subscribed for service on the Expansion Project. Again, PG&E was not able to state how the benefits of reduced PGT transportation rates will be distributed among these classes of ratepayers. Since approximately one-third of the Expansion Project's capacity within California is contracted for by Edison and SDG&E alone, it is clear that a significant proportion of those benefits will flow through PG&E's transportation-only ratepayers to end users in Southern California. On the other hand, refinancing the existing system will provide a greater benefit to existing PG&E ratepayers.

We note that the requirements of § 701.5 are met even if it is transportation-only customers of the Expansion Project that receive the major benefit. At the same time, we are concerned that to the extent there is any ratepayer risk associated with a guarantee, existing PG&E ratepayers might bear a disproportionate risk burden relative to any benefits they may enjoy. It is not our

intent to have PG&E's current ratepayers unfairly burdened for the benefit of new transportation-only customers. This concern is not easily allayed, since PG&E has not quantified the distribution of benefits among ratepayers. Accordingly, to avoid any disproportionate burden that could otherwise arise if we grant PG&E's request, we must be assured that all ratepayers are effectively shielded against any significant risk which may arise from a guarantee.

6.3 Risks to Ratepayers

6.3.1 Overall Risk

As Altamont observes, a firm's cost of debt and equity capital is a barometer of its risk. We have no doubt that PG&E will assume additional risk by taking on a guarantee of PGT's debt obligations. As opponents of PG&E's application note, the very fact that third-party lenders have demanded a parent guarantee demonstrates that the financial market perceives significant risks in lending funds to PGT at this time. We believe these lenders may have a sound basis for such a perception, given the uncertainties associated not only with the Expansion Project but other risks related to access to Canadian supplies. They are willing to provide financing with a guarantee because some of the major risks faced by PGT will be shifted to PG&E.

On the other hand, $751 million in guarantee obligations is relatively small compared to PG&E's overall capitalization. PG&E pointed out that $751 million represents approximately 3.5% of its total consolidated assets. It represents approximately 8% of PG&E's outstanding long-term debt of approximately $9 billion as of December 31, 1991. PG&E states that the because the amount of debt to be guaranteed is relatively small, the risk to ratepayers is not even measurable. A witness from Duff & Phelps testified that PG&E's financial condition as evidenced by its credit rating will not be adversely affected by a guarantee. PG&E also offered in

evidence a letter from Standard and Poor's stating that the proposed debt guarantee would not impact PG&E's credit rating.

We conclude that any effect of a guarantee on PG&E's debt cost will be relatively small and may be difficult to measure given PG&E's large asset base. We do not, however, accept PG&E's assertion that there will be no effect. Credit ratings are broad measures, and relatively small changes in risk can affect the cost of debt even though ratings are unaffected. Utility investors do not just look at credit ratings when choosing among alternative investments, they look at all known risks. Similarly, we are persuaded that, through the workings of equity capital markets, the existence of a guarantee (let alone a payment under the guarantee) can lead to incrementally higher costs of equity.

6.3.2 Ratepayer Protection

Given that PG&E will take on an increment of risk by providing a guarantee to PGT, which could potentially increase PG&E's cost of debt and equity capital, a necessary condition for our authorizing a guarantee is reasonable assurance that PG&E's ratepayers are insulated from the costs imposed by such risk. Our principal concerns are two-fold. First, we need to ensure that PG&E's shareholders and not its ratepayers will be responsible for any payment under the guarantee. Second, we need to ensure that ratepayers do not pay for incremental increase in the cost of capital that arises from the existence of a guarantee.

PG&E declares that it is willing for its shareholders to assume full responsibility for any payments that would ever be required under a guarantee. PG&E acknowledges that its cost of equity could increase under a guarantee but it points out that its authorized return on equity would not be affected under its current "Diablo Canyon" mechanism.[7] Under the Diablo Canyon mechanism,

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7 See D.88-12-083, 30 CPUC 2d 189, 263-64.

PG&E's own cost of equity is not used by the Commission in PG&E's cost of capital proceedings.[8] Additionally, PG&E proposes the following language as a condition of the guarantee authority:

> In the event that PG&E makes a payment to PGT lenders under its guarantee obligation of the $751 million PGT financing, PG&E accepts the burden of proof to establish the magnitude of any impact of such a payment upon the cost of debt, preferred, and equity capital to be recovered from ratepayers.

The Diablo Canyon mechanism now in place will insulate ratepayers from the risk of paying for higher costs of equity that might result under a guarantee. With modifications, we are also satisfied that the above-described condition will sufficiently shield ratepayers from the risk of paying for incrementally higher costs of debt as well as preferred and equity capital. PG&E does not finance all of its debt in any given year. For any given cost of capital proceeding, PG&E will be able to show the amount of debt financed in a one-year time frame and relate any impact of a guarantee to that amount of debt. By requiring PG&E to prove by affirmative showing the magnitude of any such impact, our major concerns about the difficulty of measuring them are addressed.

We do not find PG&E's agreement to assume the burden of proof to be helpful in this regard. As an applicant in its cost of capital proceedings, PG&E already has the burden to establish that its requested returns on debt as well as preferred and common equity are justified. It strikes us that more important is the

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8 Pursuant to the Commission's plan for processing general rate cases and related proceedings, PG&E now files an annual cost of capital application. (D.89-01-040, 30 CPUC 2d 576.) For purposes of this proceeding our references to cost of capital proceedings include the annual proceedings filed in accordance with D.89-01-040 as it may be modified or superseded in the future, or any other proceeding in which PG&E's ratemaking cost of capital is established.

type of showing needed to establish that ratepayers remain unharmed. As already noted, PG&E's agreement to demonstrate the magnitude of any impact of a payment is a step in the right direction.

PG&E's proposed mechanism would operate only if there is a payment to PGT lenders under the guarantee. We find that such a mechanism yields inadequate protection to ratepayers. Part of the risk for ratepayers is that an incremental increase in PG&E's debt costs will be passed through to ratepayers in the cost of capital proceeding. We will go a step further by requiring PG&E to make an affirmative showing addressing the magnitude of any impact of a guarantee on its cost of capital, not just impacts that arise in the event of a payment under a guarantee. If, in a future cost of capital proceeding, PG&E believes that its costs have not been impacted, it will be free to substantiate such a claim. Our interest is in seeing that PG&E will affirmatively raise the issue in each cost of capital proceeding so that all parties can properly address it. We will also require PG&E to report to this Commission within 10 days of any payment made under a guarantee.

New Mexico criticizes PG&E's ratepayer protection scheme. New Mexico claims that PG&E will not have an incentive to show any impact of a guarantee. We believe this concern is addressed with the modifications we adopt. We require PG&E to make an affirmative showing regarding the guarantee in each cost of capital proceeding. PG&E cannot simply ignore the subject. Also, PG&E has the burden of proof to demonstrate the impact of the guarantee, meaning that it will provide testimony and evidence. In our opinion, this provides adequate incentive for PG&E both to show the magnitude of the impact and to reduce its requested returns by the appropriate amount to remove the impact from ratepayer cost responsibility.

Altamont proposes that if we grant PG&E's application, ratepayers should be further protected by requiring PG&E to retain and pay for a nationally recognized independent consultant to

provide its best estimate of the increased costs of PG&E capital attributable to the existence of a debt guarantee. This would be done for each cost of capital proceeding. We are not convinced such an approach is required, or that is necessarily the best approach to litigation in all cases. We do reserve the right to require PG&E to pay for such a consultant from shareholder funds if, in a future cost of capital proceeding, we find it to be necessary or appropriate.

DRA and TURN suggest that if PG&E is authorized to guarantee PGT debt, any protection mechanism should provide for a rebuttable presumption holding PG&E responsible for increased capital costs. However, they do not provide any details for their proposal, including what such a presumption would be.

In the application, PG&E notes that it has announced its intention to sell PGT. PG&E states that its guarantee obligations would be assumed by the new owner as a condition precedent to the sale. We will include a similar condition in our authorization.

6.4 Alternatives to PG&E's Guarantee Proposal

It is legitimate to determine whether a guarantee is the lowest-cost alternative to meet PGT's financing needs. If there are alternatives which could yield equivalent cost savings without a guarantee, thereby yielding similar ratepayer benefits but with less potential risk for ratepayers, we should not approve PG&E's application. Similarly, if there are viable alternatives that provide lower-cost financing even with a guarantee, we should determine if such alternatives should be pursued in order to maximize ratepayer benefits.

PG&E and PGT invited 17 international banks to submit competitive proposals on pricing and structure for the $751 million PGT construction and term financing. The banks were invited to form groups as a result of the size of the request. Two such groups submitted proposals, and PG&E chose the more competitive of the two. Both required a guarantee. In fact, both PG&E's Assistant Treasurer and a Vice President of Canadian Imperial Bank

of Commerce testified that third-party financing of PGT without a guarantee is unavailable.

Altamont suggested an alternative of financing the Expansion Project through issuance of PG&E mortgage bonds. We find no advantage in this alternative, and we note further that it does not have the potential for eliminating PG&E's risk once certain milestones are met, as a guarantee does.

PG&E's witness acknowledged that lower-cost financing could be available with a non-project-based structure using public debt. However, that alternative would also require a guarantee. PG&E and PGT believe that project-based financing is preferable. With project financing, once certain milestones are met, the guarantee will be released. We agree. While it is true that PG&E has requested authority for a 12-year guarantee, and the milestones that are likely to be part of any guarantee could take years to be fully met, we are persuaded that the ability for PG&E to be released from any obligation once milestones are met makes its credit facility proposal preferable.

PITCO argues that PGT's existing debt could have been refinanced at lower cost to existing PGT customers than under PGT's approach of financing both the existing system and the Expansion Project. However, PITCO does not see that as an option in the context of this proceeding. Given that, it recommends approval of the application.

PITCO does, however, question PGT's need for financing on the existing system for expenditures in excess of $51 million, the amount needed for refinancing existing PGT debt.[9] PITCO recommends that the Commission withhold approval of any existing system debt financing pending a complete statement by PG&E and PGT regarding the specific purposes for which those funds may be necessary. PITCO has not shown why we should specify the uses of

9 As noted above, PGT's planned uses for an additional $35 million are not specified.

the debt proceeds in the manner it requests. We are being asked to authorize PG&E to guarantee up to $751 million of PGT's debt without precise specification of the uses thereof by PGT. For the reasons explained above, we have decided to limit the uses to the purposes stated in the application by PG&E. Our analysis of the risks and benefits of a guarantee set forth above is not directly affected by the nature of the capital improvements made.

6.5 Conclusion

Guaranteed debt financing is less costly than equity financing or any other financing alternative available to PGT. Over time, we fully expect a portion of PGT's financing cost savings to be passed through to PG&E ratepayers. The ratepayer benefits from a guarantee of PGT debt will almost certainly be less than $52.7 million but they will still be substantial. Much of the benefits that are realized are likely to be received by transportation-only customers of the Expansion Project but some will be received by existing PG&E ratepayers with the refinancing of existing debt. We therefore find that there are ratepayer benefits. PG&E and its subsidiary PGT will also benefit through enhancement of PGT's ability to compete through lower capital costs.

Also, while there is added risk to PG&E as a result of a guarantee, the mechanism which we adopt today satisfies our concern that ratepayers could be saddled with risks which outweigh the benefits they are likely to receive. Thus, while ratepayer benefits will be less than $52.7 million, neither are they offset by risks that may remain with adoption of the proposal. We conclude that with the conditions we adopt today, a blanket grant of guarantee authority as requested by PG&E will result in net ratepayer benefits.

7. Consistency With "Market Forces" Policy

In D.90-02-016, the Commission departed from its past practice of determining need for pipeline capacity on a case-by-case basis, and instead elected to "let the market decide" whether

and when new pipeline capacity would be constructed. The Commission applied this same policy in issuing a certificate for the PG&E portion of the Expansion Project. (D.90-12-119, mimeo. p. 92.) The opponents argue that Commission approval of a guarantee would erode this market-based policy. They claim that the need for a guarantee shows that PGT has failed the market test.

As PGT aptly explains, this issue consists of two questions. The first is whether a debt guarantee can be viewed as an artificial or unfair form of support for a project that under the Commission's guidelines is supposed to be capable of withstanding the harsh test of the marketplace. The second question here is whether PG&E's status as a state-regulated gas utility somehow makes it an inappropriate guarantor of the debt incurred by a subsidiary in undertaking an interstate gas pipeline project.

With respect to the first question, the evidence shows that the other new or proposed interstate gas pipeline projects serving California have had or will have sponsor guarantees, which is what PG&E requests authority for here. The Vice President of a bank included in the group which has submitted a proposal to PG&E and PGT testified that regardless of the particular form the sponsor's completion assurance might take, "the minimum acceptable level of protection to be required by a lender on a project such as this is that their debt would be repaid if certain milestones are not achieved. ..." (Tr. 252, line 28, to Tr. 253, line 3.) The only difference is that the sponsors of these other pipeline projects -- in contrast to PG&E -- are not required to obtain regulatory approval before entering into such sponsor support arrangements.

It is clear that the existence of a sponsor guarantee does not, alone, represent any inconsistency with a market-driven policy. In fact, as PGT notes, if it is denied the opportunity to finance the Expansion Project with a guarantee from PG&E, while its

direct competitors (Kern River, Mojave and Altamont) are able to use sponsor guarantees, PGT will be placed at an disadvantage in attempting to obtain financing. The general lender criteria that the project be free of significant litigation and regulatory risks before the sponsor guarantee is lifted are the same for the Expansion Project as they are for stand-alone projects.

With respect to the second question, we find little support for the proposition that PG&E's status as a regulated gas utility has any bearing on whether the proposed debt guarantee meets the Commission's let-the-market-decide policy criteria. This would be a valid and serious concern if PG&E ratepayers were liable for costs or risks from a guarantee. Since we are adopting safeguards to isolate ratepayers from any guarantee, we find that approval of PG&E's request does not contravene our market-based policy.

Findings of Fact

1. PG&E requests authority under § 701.5 and § 830 to guarantee the debt financing of up to $751 million of PGT debt, which is planned primarily for financing the PGT segment of an expansion of PG&E's and PGT's Canada-to-California natural gas pipeline, as well as the debt refinancing and capital improvements of PGT's existing pipeline system.

2. PG&E seeks authority to provide a guarantee for or on behalf of PGT, a wholly owned subsidiary which engages in activities which support PG&E in its operations or service, and which activities are, or will be, regulated by FERC, a federal agency which is comparable to this Commission.

3. As the application was originally filed, PGT's planned uses of the $751 million guaranteed debt were for capital costs for the PGT portion of the Expansion Project ($594.7 million); a lender-required project contingency fund of 10% ($59.5 million); debt refinancing and capital improvements related to the existing PGT system ($85.7 million); and closing costs ($11.1 million).

4. Specifying in broad terms the uses of the guaranteed debt, rather than allowing PGT to use the funds without limitation, provides greater assurance that utility and ratepayer benefits will be realized.

5. While it is reasonable to grant PG&E and PGT flexibility in allocating loan proceeds among the purposes listed in Finding of Fact 3, it is also reasonable to limit the uses to those purposes and further require that the majority of the proceeds be allocated to the Expansion Project.

6. The cost of guaranteed debt financing will always be less than that of financing using PG&E equity-funded loans to PGT.

7. A loan guarantee such as that contemplated by PG&E will result in lower capital costs for the PGT system.

8. Commencing in 1994, FERC-approved PGT transmission rates will be millions of dollars lower as a result of guaranteed debt than they would be in the absence of such a guarantee.

9. To the extent that gas moving over the existing system and the Expansion Project is priced under netback arrangements, any benefit of reduced PGT transportation rates will, in the short run, accrue largely to producers. However, since the supply contracts are not exclusively netback, ratepayers will benefit from reduced transportation rates.

10. PG&E is intent on pursuing efforts to remove netback pricing in its own supply contracts.

11. Over time, PG&E's efforts to eliminate netback pricing provisions will diminish the extent to which netback pricing reduces PG&E ratepayer benefits.

12. As PGT transportation costs are lowered due to lower capital costs, there should be more aggressive competition resulting in lower gas costs to end users.

13. Substantial ratepayer benefits will be realized by transportation-only customers of the Expansion Project as well as

by existing PG&E customers through refinancing of existing PGT debt.

14. The $751 million guarantee obligation represents approximately 3.5% of PG&E's total consolidated assets. It represents approximately 8% of PG&E's outstanding long-term debt of approximately $9 billion as of December 31, 1991.

15. Any potential effect of a guarantee on PG&E's debt cost will be relatively small.

16. The Diablo Canyon mechanism will insulate ratepayers from the risk of paying for higher costs of equity that might result under a guarantee.

17. PG&E's proposes a burden-of-proof mechanism that would operate only if there is a payment to PGT lenders under the guarantee. Such a mechanism yields inadequate protection to ratepayers.

18. While any effect of a guarantee on PG&E's debt cost may be difficult to measure, the ratepayer protection measures we adopt in this order provide assurance that even small effects will be considered and isolated from ratepayers in cost of capital proceedings.

19. PG&E and PGT will benefit from a financing guarantee through enhancement of PGT's ability to compete through lower capital costs.

20. With the conditions we adopt in this order, the proposed financing will benefit the interests of PG&E.

21. With the conditions we adopt in this order, the proposed financing will benefit the interests of PG&E's ratepayers.

22. We do not find any superior financing alternative to PG&E's proposal for project-based financing, with the conditions we are adopting.

23. Other new or proposed interstate gas pipelines serving California have had or will have sponsor guarantees.

24. With the ratepayer protections we are adopting, PG&E's status as a regulated utility has little bearing on whether the proposal is consistent with our market-based policy.

Conclusions of Law

1. El Paso's motion requesting permission to file its brief one day late is granted.

2. The ALJ's August 18 ruling limiting the scope of evidence to be heard in this proceeding is affirmed.

3. PG&E's financing proposal falls squarely under the situation described in subdivision (c) of § 701.5 and is, therefore, eligible for an exception to § 701.5's general prohibition.

4. We are not precluded by § 701.5 from considering the application on its merits, even though the terms and conditions of the guarantee are not known to us at this time.

5. Section 830 does not preclude a grant of blanket financing authority.

6. The authority should be conditioned by limiting the uses to which PGT may put the guaranteed debt proceeds to those purposes stated by PG&E in the application.

7. Under § 701.5 the Commission must find that PG&E's proposal will benefit the utility and its ratepayers before PG&E can be authorized to pledge its assets or credits. In determining whether benefits will result or not, the statute does not require absolute certainty that benefits will result; a showing by a preponderance of evidence is sufficent.

8. The requirements of § 701.5 are met even if it is transportation-only customers of the Expansion Project that receive the major benefit.

9. PG&E should make an affirmative showing addressing the magnitude of any impact of a guarantee on its cost of capital, not just impacts that arise in the event of a payment under a guarantee. This condition will sufficiently shield ratepayers from

the risk of paying for incrementally higher costs of debt as well as preferred and equity capital.

10. PG&E should be required to report to this Commission within 10 days of any payment made under a guarantee.

11. PG&E's shareholders and not its ratepayers should be liable for and at risk for any payment under the guarantee. The guarantee should be for a maximum term of 12 years and should terminate immediately in the event of a sale of PGT.

12. Since other interstate pipelines have had or will have sponsor guarantees, and PG&E ratepayers are isolated from the guarantee's potential risks, approval of the guarantee proposal does not contravene the Commission's market-based policy for gas pipeline capacity matters.

13. This order should be made effective today to enable PG&E and PGT to implement lower-cost financing of the PGT system and the PGT segment of the Expansion Project at the earliest possible date.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized to pledge its utility assets for or on behalf of its subsidiary, Pacific Gas Transmission Company (PGT), for the purpose of guaranteeing PGT debt in a principal amount not to exceed $751 million, subject to the following conditions:

   a. Any agreement providing for a PG&E guarantee of PGT debt shall also provide that the maximum term of the guarantee is 12 years.

   b. Any agreement providing for a PG&E guarantee of PGT debt shall provide that, in the event of sale of PGT by PG&E, any guarantee obligations of PG&E shall be terminated immediately.

c. Any agreement providing for a PG&E guarantee of PGT debt shall provide that the uses of the guaranteed borrowings shall be limited to capital costs for the PGT Expansion Project, any lender-required contingency fund, refinancing of existing PGT debt, capital improvements for the existing PGT system, and closing costs. The agreement shall further provide that the majority of any borrowings shall be used for the PGT Expansion Project.

d. It is the Commission's intent that PG&E ratepayers shall not indemnify PG&E, PGT, or creditors for any costs or payments resulting from a guarantee of PGT debt. It is the Commission's further intent that PG&E shareholders are liable for and at risk for any payment by PG&E to PGT or its creditors under a guarantee. PG&E shall not in any future cost of capital proceeding assert any right to receive compensation from ratepayers for costs resulting from any increment in its cost of capital which is attributable to the existence of a guarantee or any payment under it.

e. The Commission reserves the right to order PG&E to pay for from shareholder funds a nationally recognized independent consultant to provide its best estimate of the increased costs of PG&E capital attributable to the existence of a debt guarantee, if, in a future cost of capital proceeding, the Commission finds such order to be necessary or appropriate.

2. PG&E is directed to submit the following reports to the Commission:

a. PG&E shall report to the Commission within 10 days of any payment made under a guarantee obligation.

b. PG&E shall submit a copy of any guarantee agreement to the Commission within 10 days of the date executed.

An original and four copies of the reports and documents required by this Ordering Paragraph shall be submitted to the Commission Advisory and Compliance Division, which shall file the original of each submission with the Docket Office.

3. The following ratepayer protection mechanism is also adopted:

> If PG&E assumes obligations of PGT debt as guarantor in accordance with Ordering Paragraph 1, in each subsequent annual cost of capital proceeding (or successor proceeding) PG&E shall have the burden of proof to establish the magnitude of any impact upon the cost of debt, preferred, and equity capital to be recovered from ratepayers resulting from the existence of the guarantee or from any payment under the guarantee. PG&E shall include in its prepared testimony in any such proceeding its calculations of the impact along with supporting testimony. Any increase in PG&E's cost of debt, preferred, and equity capital attributable to the guarantee shall not be included in PG&E's authorized costs of capital.

This order is effective today.

Dated October 21, 1992, at San Francisco, California.

DANIEL Wm. FESSLER
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY

NEAL J. SHULMAN, Executive Director

APPENDIX A

Applicant: Julie C. Gavin, Michelle Wilson, and Bruce R. Worthington, Attorneys at Law, for Pacific Gas and Electric Company.

Protestants: Peter V. Allen and Michel P. Florio, Attorneys at Law, for Toward Utility Rate Normalization; James F. Bendernagel, Jr. and Frederic G. Berner, Jr., Attorneys at Law, for Altamont Gas Transmission Company; and Wayne Lepire and Randy Wu, Attorneys at Law, and Andrews & Kurth, by Kenneth L. Wiseman, Attorney at Law, for El Paso Natural Gas Company.

Interested Parties: Rand Carroll, Attorney at Law, for State of New Mexico; Leonard A. Foster and David J. Gilmore, Attorneys at Law, for Pacific Interstate Transmission Company; Le Boeuf, Lamb, Leiby & MacRae, by Frank R. Lindh, Attorney at Law, for Pacific Gas Transmission Company; Edward G. Poole, Attorney at Law, for Anderson, Donovan & Poole; Morse, Richard, Weisenmiller & Associates, Inc., by Robert B. Weisenmiller, for MRW Associates, Inc.; Kevin Woodruff, for Henwood Energy Services, Inc.; Thomas E. Hirsch, III, Attorney at Law, for Canadian Imperial Bank of Commerce, Barclay Bank, PLC, Swiss Bank Corporation and First National Bank of Chicago; Andrew Brown, for Barakat & Chamberlin; and Andrew J. Skaff, for himself.

Division of Ratepayer Advocates: Diana L. Lee, Attorney at Law.

(END OF APPENDIX A)