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Decision 99-11-053 November 18, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Pacific Gas and Electric Company to Restructure and Establish Natural Gas Rates; Modify its Core Aggregation and Core Subscription Programs; Obtain Approval of the Principles of a Post-1997 Core Gas Procurement Incentive Mechanism; and Obtain Approval of Principles for Disposition of its Gas Gathering Facilities.	Application 96-08-043 (Filed August 21, 1996)

OPINION REGARDING ENRON'S EMERGENCY MOTION, AND COMMISSION'S INVESTIGATION INTO PG&E'S BIDDING BEHAVIOR IN OPEN SEASON AUCTION

Summary

The investigation into the bidding behavior of Pacific Gas and Electric Company's Utility Electric Generation department during the Open Season auction of natural gas transportation capacity on the Redwood Path is closed without further action. However, a discussion of the allegations is set forth. The emergency motion of Enron Capital & Trade Resources and Enron Energy Services is now moot.

Background

Enron Capital & Trade Resources and Enron Energy Services (Enron) filed an emergency motion requesting disclosure of the results of the "Open Season" auction for allocation of firm backbone transmission capacity on the Pacific Gas and Electric Company (PG&E) pipelines known as the Redwood Path[1]. This motion was filed on February 24, 1998, following the auction period of December 1, 1997 to January 30, 1998. Enron was concerned about the effects of the bidding strategy pursued by PG&E's Utility Electric Generation (UEG) department on the market as well as on ratepayers. Enron requested public disclosure of all awards of capacity to the UEG and all awards of capacity to any entity affiliated with PG&E. Enron suggested strongly that the UEG had subsidized costs that should have been the responsibility of PG&E's shareholders, and violated the affiliate transaction rules in Decision (D.) 97-12-088 by brokering unneeded backbone capacity. Enron also raised concerns regarding PG&E's domination of transportation capacity, suggesting that its power in the secondary market might influence the price of Canadian gas, and the value of capacity on PG&E's other backbone paths.

In response, on February 26, 1998, PG&E disclosed that its UEG had bid for 716 thousand decatherms per day (MDth/day) of capacity for the maximum term (58 months) at the full tariff rate and had been awarded 232 MDth/day of capacity on PG&E's Redwood Path. PG&E acknowledged that it did so despite its intention to have divested all but one of its gas-fired UEG facilities by October 1, 1998. PG&E also indicated that its UEG had pre-arranged transactions in the secondary capacity market to supplement its bid in the open season.

Other parties also responded to Enron's motion[2]. The Utility Reform Network (TURN) pointed out that it had already brought up its concerns about

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[1] This auction implemented part of the "Gas Accord" settlement agreement approved in D.97-08-055 on August 1, 1997.

[2] TURN, and the California Industrial Group and California Manufacturers Association (CIG/CMA) agreed with Enron that disclosure of the awards to affiliates was necessary.

Footnote continued on next page

the UEG's bid in PG&E's divestiture proceeding, Application (A.) 98-01-008. In that case, TURN questioned how PG&E planned to deal with excess capacity in the context of the divestiture of its generation plants. TURN sought assurance that the sale of excess capacity would not inure to the benefit of shareholders only.

On March 13, 1998, the assigned Commissioners in this proceeding issued a ruling regarding the emergency motion filed by Enron. The Assigned Commissioners' Ruling (ACR) expressed concerns about the potential for anticompetitive effects:

> "Enron's motion raised several concerns about the potential for anticompetitive effects arising from the bidding and allocation rules of the open season or from PG&E's bidding strategy. Even if Enron now has in its possession the information it sought in the motion, the Commission has an obligation to look into some of the allegations made in the motion. Accordingly, we will direct PG&E to submit information about the results of the open season so that our staff may investigate these allegations further. We will recommend that the Commission take further action if appropriate, but we are not committing to any specific steps at this time."

The ACR also ordered Enron to comment on PG&E's suggestion that Enron's motion was now moot.

In a March 23, 1998 response to that order, Enron acknowledged it had received the information requested, but supported the Commission's intent to examine the UEG's bid in the open season.

Additionally, CIG/CMA requested a workshop to address other remedial measures for what it viewed as PG&E's market distortion. Specifically, CIG/CMA suggested that the UEG and cogenerators get only the capacity they actually need while other maximum bidders receive a prorated amount of capacity.

On March 23, 1998, PG&E submitted responses confidentially to the Energy Division of the Commission and an investigation by the Energy Division ensued.

Meanwhile, on March 25, 1998, in the PG&E divestiture case, A.98-01-008, TURN and PG&E stipulated that all intrastate capacity assignment revenues (less any capacity assignment costs) would be included in the weighted average cost of gas for the purposes of calculating fuel costs in its Must-Run Fossil Plant and Non-Must-Run Fossil Plant Memorandum Accounts, or any successor account. Any credit balances in these accounts would be transferred to the Transition Cost Balancing Account (TCBA) or its successor account. With the qualification that only credits, and not debits, could be transferred to the TCBA, the Commission adopted this stipulation in D.98-07-092, slip op. at pp. 31-32.

On May 21, 1999, a newly assigned Administrative Law Judge issued a ruling requesting comments on PG&E's April 28, 1999 market assessment report and ordered PG&E to answer nine questions[3] by June 4, 1999. PG&E filed its

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[3] 1. How much capacity is currently auctioned on the Redwood Path? Please provide the auctioned capacity in the primary market and secondary market. In addition, provide a breakdown for both currently available capacity and capacity that will become available in future years. Also, provide a breakdown of capacity that is currently rolled into the cost of existing capacity as per the Gas Accord, and expansion capacity subject to FERC rates (if any).

2. How much capacity does PG&E's UEG Department currently hold?

3. Provide, under seal if necessary, a table showing current capacity assignments on the Redwood Path for holders of capacity.

4. In addition, provide the information requested in the ACR issued in March 1998, which should be updated to account for all recent events.

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responses on that date. Calpine Corporation's intervention was moved and granted on June 10 and 11, 1999, respectively. Calpine, California Generation Coalition (CGC), and TURN commented on PG&E's responses on June 18, 1999[4].

In addition, the Gas Strategy Rulemaking (R.98-01-011) took evidence on the UEG's bidding behavior in the Open Season auction. On July 8, 1999, in D.99-07-015, we decided to address "PG&E UEG conduct, the outcome of the open season, and treatment of any premiums subsequently earned by the UEG in the secondary market" in this proceeding. (D.99-07-015, slip op. at pp. 27-28 fn. 6.) However, we also stated that "clear processes to allocate [] firm and secondary capacity [is] an important component in [the effort to create firm, tradable capacity rights on the intrastate natural gas transmission systems]." (D.99-07-015, supra, at pp. 29-30.) Since it is our intention to implement these rights with the Legislature's support, revision of auction rules should be part of

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5. Explain the impact of divestiture of PG&E's fossil fuel plants on the capacity required by PG&E's UEG Department. Specifically, what has become of that capacity now that PG&E's UEG Department no longer needs it?

6. Was PG&E's bid for capacity conducted in accordance with the Gas Accord Open Season rules? Was PG&E's bid independent?

7. Did PG&E's bid reduce shareholder risk at the expense of other customers? Did PG&E collect premiums on the capacity on the secondary market? How much were the premiums? If any, should the premiums be returned to purchasers? If not, should the premiums be passed through to gas customers, instead of electric customers?

8. How should future auctions be conducted to avoid potential anticompetitive concerns?

9. Are hearings required to consider these issues?

[4] We note and find some significance in the fact that Enron, the entity initiating this investigation, did not file any further comments.

any settlement or decision emanating from I.99-07-003, which is the second phase of our Gas Strategy proceeding.

Discussion

Our investigation indicates that Enron's initial motion for public disclosure of certain information was long ago made moot by PG&E's disclosures of this information. (See Enron's response of March 23, 1998.) However, we felt a responsibility to look further into the bidding behavior of the PG&E UEG pursuant to our authority under Pub. Util. Code § 761.

Facts[5]

The facts are not in dispute. During the December 1997 through January 1998 open season auction for backbone transmission capacity[6], PG&E's UEG department submitted a bid for 100 percent of the available capacity on the Redwood Path at the full tariff rate for the full remaining term of 4 years and 10 months. PG&E, however, initiated proceedings to divest itself of nearly all of its gas-fired electric generation capacity by the end of 1998 and had little need for

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[5] Official notice is taken of the facts reflected in the exhibit and transcript portions cited by all parties. These references are to the record of admitted evidence in R.98-01-011 (Gas Strategy Phase I) and the settlement document in A.92-12-043 (Gas Accord).

[6] Section IIE5 of the Gas Accord lays out the rudiments of the Open Season Auction in subsections (g) and (h):

g. PG&E will conduct an open season among all creditworthy parties to award remaining intrastate firm transmission service for at least the minimum term and at the full tariff rate under the AFT, AFT-Off, or SFT service. Firm capacity will first be awarded under the AFT and AFT-Off service. Any remaining firm capacity will then be awarded under the SFT service.

h. If a particular path is oversubscribed in the open season, PG&E will award available firm capacity based on PG&E's determination of the highest economic value of each bid to PG&E's gas transmission department, as determined by PG&E.

the transportation capacity in the latter years of the term. PG&E's UEG also arranged in advance to maximize its chances of having enough capacity to serve its remaining generation plants at low cost not only by its full tariff full term bid, but by taking assignment of the capacity awarded to another purchaser.

Under the Gas Accord, PG&E's California Gas Transmission Department (CGT) then had to inform cogenerators of the UEG's bid; PG&E's CGT only informed cogenerators of the UEG bid, not the pre-arranged assignment from another bidder – at the time, CGT did not know of this pre-arranged secondary market transaction. The cogenerators then had until February 4, 1998, to submit bids for the capacity they needed. Some cogenerators also submitted full term bids at full tariff.

When the results were in, PG&E's UEG had accrued more than a 30 percent share of the available capacity after a pro rata distribution among the highest bidders. With its assigned capacity, the percentage was 60% in the initial year of the term. (See Table 1.)

TABLE 1

Redwood Path Available Capacity Auction

	Mar-98	Mar-99	Mar-00	Mar-01	Mar-02
Capacity Available (MDth/d)	716	716	973	973	973
Capacity Awarded to UEG (MDth/d)	232	232	232	232	232
% of total cap. awarded to UEG	32%	32%	24%	24%	24%
Cap. acquired by UEG through a pre-assignment (MDth/d)	197	197	197	197	197
Total cap. including pre-assignments acquired by UEG (MDth/d)	429	429	429	429	429
% of total cap. acquired by UEG (directly and through pre-assignment)	60%	60%	44%	44%	44%

1. Capacity figures shown here are for the initial month and each subsequent twelfth month following the implementation of the Accord. The capacity figures fluctuate somewhat for the months in between.

Source: Feb. 26, 1998 Response of PG&E to Emergency Motion of Enron, p.1; Tr. p.927, in R.98-01-011;Gas Accord at pp 17-18 and Exhibit 15, p.4-3, in R.98-01-011, PG&E's Market Conditions Report Rebuttal Testimony .

To whittle its acquisition down to what it needed, the UEG immediately sold almost half the capacity acquired in the Open Season before the March 1, 1998, commencement of the Gas Accord period. As of April 1999, it had no remaining capacity, although it expects some reversions later in the Gas Accord term. All told, the UEG has sold its excess capacity in the secondary market at approximately a $9 million premium over the amount it paid less costs of sale. As noted above, the premium over purchase price has been applied to the TCBA which provides for accounting associated with the recovery of electric system transition costs. This application benefits electricity ratepayers as well as ultimately benefiting shareholders by accelerating the recovery of transition costs. Simultaneously, the sale of excess capacity at a premium eliminated PG&E shareholder risk for transportation as a cost of generation. Additionally, though, PG&E's ratepayers reaped the benefit of the lower cost gas from Canada coming from Malin on the Redwood Path. PG&E estimates this savings at about $27 million.

The terms of the Open Season auction of transmission capacity for the Redwood Path are set forth in Sections IIE5(g) and (h) of the Gas Accord (Appendix B to D.97-08-055). Under those rules, firm capacity is first awarded to bidders for firm annual capacity, on or off system. If a particular path is oversubscribed, PG&E can determine the highest economic value of each bid and base awards of capacity on this perceived value to its gas transmission department. Under section IIE7(b), PG&E cannot be required to sell capacity at less than the full tariff rate, and under section IIE8(a), all transmission contracts are assignable.

Additionally, PG&E issued a January 16, 1998 memorandum to potential bidders indicating the exact formula and procedures PG&E would use in calculating value of bids. This memorandum made it clear that the primary determinants of value were length of term and reservation rate, not quantity.

Positions

While the facts are accepted, the motives behind the bidding strategy are very much in dispute. PG&E claims that it wished to ensure that its generation plants would have the lowest cost gas for the remainder of PG&E's ownership term, and that it expected that Redwood Path capacity would be so oversubscribed that pro rata allocation would become necessary. Because the value formula weighted term length heavily, PG&E decided that it was necessary to bid for the maximum amount of capacity at the full tariffed rate for the maximum remaining term, despite the fact that it did not expect to have generation plants for the entire term. If it bid for less than full term, PG&E thought that its bid would be beaten by other shippers, including cogenerators, that bid a slightly longer term. PG&E asserts that the amount of capacity for which it bid was a function of its calculation of its average daily need before the second wave of divestitures and its belief that the oversubscription for the full term would be by a factor of 5. PG&E now acknowledges that its oversubscription expectation was incorrect.

The other parties believe that the primary motivation was to minimize the risk that PG&E shareholders bore for any unsold or undersold capacity. By controlling the secondary market for capacity and forcing the price up, PG&E would more likely recover all costs for transportation.

We asked the questions below in our investigation, and received information allowing us to come to the following conclusions.

- **Did the UEG's auction and post-auction behavior violate the "affiliate transaction rules," or in any other way lack independence?**

PG&E's UEG was not allowed to coordinate its bid with its affiliates or other PG&E departments, such as its California Gas Transmission department, or its Core Procurement Department. There is, however, no evidence that it did so, and PG&E vehemently denies doing so. The speculation of the other parties is not a basis for any action by the Commission.

Enron suggested that the UEG may have violated the affiliate transaction rules issued in D.97-12-088 as modified in D.98-08-035 by brokering a new product (secondary market capacity) at a non-tariffed rate. Rule VII.C.4.b of the affiliate transaction rules prohibits selling a non-tariffed product or service unless that product or service was acquired for the purpose of and is necessary and useful in providing tariffed utility services. PG&E responds that acquiring its excess capacity was necessary under the circumstances of its expectation of oversubscription of the Redwood Path. PG&E also says that the UEG has brokered pipeline capacity before, and thus excess capacity is not a "new product."

We note also that the original affiliate transaction rules (D.97-12-088) were already in the comment process at the time of the creation of the Gas Accord's secondary market in transmission capacity (D.97-08-055). The Commission approved a secondary market without a cap on price and in which the UEG is to function as any other participant. We do not believe that the intent of the affiliate transaction rules was to prohibit what the Commission had just approved - the UEG's participation in this secondary market.

Enron also sees a violation of the affiliate transaction rules in not releasing a complete list of awards to UEG and affiliated companies. Rule IV.F requires that an entity make available for third-party review all tariffed and nontariffed transactions with its affiliates upon 72 hours' notice. PG&E replies that the affiliate transaction rules, including Rule IV.F cited by Enron, do not cover intra-company transactions between departments or tariffed transactions from open competitive bidding. We need not affirm this view to note that PG&E disclosed affiliate transactions pursuant to Rule IV.F, and also disclosed non-affiliate transactions under seal. Enron indicated satisfaction with the disclosure in its March 23, 1998 letter.

Enron also cites Rule 26 of the PG&E tariff (See Resolution G-3288 November 19, 1997, p. 10). PG&E claims Rule 26 only covers negotiated transactions between intra-company departments, not the UEG's full tariff rate bid in the Open Season auction. Again, the disclosure was made so the point is moot.

- **Did the UEG's bidding strategy violate the Gas Accord?**

The Gas Accord is attached as Appendix B to D.97-08-055, and governs many facets of the new gas market structure in Northern California[7]. PG&E asserts that the Gas Accord does not address public disclosure or provide rules for operation of the secondary market. Indeed, it does not appear that PG&E has run afoul of the Gas Accord as written.

The Gas Accord does address the subsequent allocation of remaining intrastate transmission capacity (in Section IIE7 (a) and (b)) and contract assignment in Section IIE8. Contract assignments are subject to a notification requirement, a creditworthiness requirement, and may be facilitated by the use

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[7] In approving the Gas Accord, the Commission nevertheless found that PG&E holds market power in California and had conflicts of interest in marketing its Redwood Path capacity. The Commission retained its authority to address continuing conflicts of interest. We do so herein.

of a PG&E posting board. Section IIE.16(c) concerns PG&E's obligation to provide nonpublic information about the intrastate transmission system to all entities without undue preference or undue discrimination. Under the facts as set forth, there is no showing that PG&E has violated any aspect of these general sections or the more specific Rules of the Open Season that were set forth in the January 16, 1998 memo from the CGT manager.

The allegation that the notice to cogenerators was insufficient also appears to be without support. In the Gas Accord at Section III.11(f), it is agreed that

> During open seasons for intrastate transmission capacity, PG&E will notify on-system cogenerators of UEG's elections for service from PG&E's transmission department three business days prior to the date that cogenerators must make their service elections. PG&E will also notify on-system cogenerators of UEG's other elections for service from PG&E's transmission department as they may occur from time to time. This will apply only to UEG service agreements whose (sic) durations are more than 30 days.

PG&E submitted a copy of its notice to cogenerators as Attachment 12 of its June 10, 1999 filing in response to the ALJ's Ruling Regarding Comments on Market Assessment Report and Requesting Additional Information. It appears to be appropriate and no evidence was submitted showing otherwise.

The pre-arranged deal with a third party is troubling because, as noted by Calpine, such pre-arrangements could be used to skirt the cogenerator notice requirement entirely. In this instance, the letter of the notice requirement was followed and the cogenerators received real notice that a full term bid would be required to get capacity. Thus, we see no violation here, but note that new auction procedures should address pre-arranged assignments.

The CGT did not know of the pre-arranged assignment, nor should it have known of it, and therefore could not report it. Secondary market transactions, whether pre-arranged or not, are not covered by the notice provision as stated in the Accord. This was a policy choice that can be reassessed in I.99-07-003; at the time it occurred here, it was not a violation of the Gas Accord.

- **Did PG&E act in an anti-competitive manner by exercising undue market power in either the primary or the secondary market?**

<u>Primary Market</u>

Under the terms of the Gas Accord, the standard tariffs had to be paid for any Open Season capacity. Thus, price in the primary market was not affected by the UEG bid. Moreover, all the successful bidders made full term bids. Even if the UEG had bid for less capacity, and its assignor had bid for less capacity, but at full term, the same bidders would have received capacity, albeit at a higher pro rata level. The CGT would have still received the same price for the capacity it sold.

Thus, PG&E's market power did not distort the primary market in price or term[8]. The lower bidders would still have been without capacity. We acknowledge that the high bidders did have their pro-rated shares diminished, but this does not rise to market distortion.

We do not see abuse of market power in the primary market. Granting that the UEG did not need capacity for the full term, there is nothing prohibiting its strategy of making large full term bids to ensure that it received all the short-term capacity it needed. Moreover, PG&E took the risk that it would be unable to sell its excess later term capacity at the tariff price. Any bidder with the credit could have done the same thing, taking the risk of loss as well as gain.

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[8] We do not have evidence that the cogenerators bid as they did only because of the UEG's bid, although notice is, of course, intended to have an effect on cogenerator bids.

Enron claimed in its Emergency Motion that the UEG's bid likely caused cogenerators (who were informed of the bid) to inflate their bids in order to secure backbone capacity. There was no set-aside in the Gas Accord for cogenerators. They did receive an advantage in that their bids could factor in what the UEG bid, in addition to whatever other factors they considered. It appears that the intent of the notice provision was to afford cogenerators the opportunity to raise their bids in reaction to the UEG's bid in order to obtain capacity at the tariff rate. Thus, the mechanism worked as planned.

Secondary Market

By initially acquiring 60% of the available capacity, the UEG exercised the power of its parent's market share – it had the capital to make a huge bid. The allegation is that by cornering the primary market, the UEG artificially raised the price in the secondary market. However, our investigation has shown that available capacity was oversubscribed for the entire term of the Gas Accord. Under these circumstances, it would be surprising if the secondary market capacity did not sell at a premium.

In the first two years of the term, the capacity was oversubscribed by more than a factor of 3, so that even without the bids of the UEG and its assignor, the Redwood Path would have sold out its full capacity.[9]

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[9] PG&E's June 10, 1999 Responses to the Administrative Law Judge's Ruling Regarding Comments on Market Assessment Report and Requesting Additional Information, Attachment 9, at p. 23, states that full term requests on the Redwood path exceeded available capacity by about 3.1 times in 1998. Our investigator confirmed this. Since the total capacity awarded in the auction was 716 MDth/d, we deduce that the total capacity requested for the full term was 3.1 x 716 MDth/d or 2219.6 MDth/d. Since both the UEG and its assignor bid for the full capacity of the Redwood Path, we can safely conclude that without the bids of the UEG and its assignor, the total Redwood Path requests would have amounted to 787.6 MDth/d (2219.6-(716x2)), and the bid

Footnote continued on next page

In the later years of the Accord term, the capacity was oversubscribed by a smaller factor of 2.3[10] because of the increase in available capacity (973 MDth/d instead of 716 MDth/d). (Exhibit 15, pp.4-3 to 4-4, PG&E's Market Conditions Report Rebuttal Testimony, in R.98-01-011.) While it cannot be said that without the bids of the UEG and its assignor, the full capacity would have been sold out (973 x 2.3=2237.9; 2237.9-(716x2)=805.9; bid multiple 973/805.9=1.2), it is beyond cavil that the UEG and its assignor would have had real use for the remaining 167 MDth/d. Therefore, capacity in the secondary market could command a premium even had the UEG participated only at a low level.

We acknowledge that from February 1 to sometime before March 1, 1998, the UEG's share of excess transportation capacity indicated market power in the secondary market. However, the UEG immediately shed most of its excess, albeit at a premium. Given the inherent risk in gaining this control, especially for the latter part of the Gas Accord term, the short length of time involved and the disposition of the premium (see discussion below), we do not believe it is necessary to act in any way at this time in response to this short-lived power.

Nor do we think that the evidence that Redding's and other cities' gas transportation costs rose after the inception of the Gas Accord period indicates an abuse of market power. (CGC Comments on Market Assessment Report, Att. B, which is R.98-01-011's Ex. 12, CGC's Rebuttal to Market Conditions Report, Testimony of Cope, Att. 3 at pp. 8-9.) Customers like Redding use

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multiple, the ratio of capacity awarded to capacity bid, would have been 716/787.6 or .91.

[10] The total of full term full tariff bids (2219.6) divided by the available capacity (973) equals 2.3 with rounding.

electric generation facilities as peaking facilities and do not normally bid for capacity in the open season because they would use their firm capacity only a small percentage of the year. Moreover, it would not be cost-effective to buy capacity and sell the excess in the secondary market, because that would entail hiring extra personnel to perform that function on a day-to-day basis. Thus, they use secondary capacity .

Cope's testimony shows that the overall price has been driven up. (Id. at Att. 3 pp. 9-10.) This is, of course, unfortunate for small customers. But for the first two years of the term, the Redwood Path capacity would have sold out without the UEG bid, and these small customers would have had to pay a premium for transportation. As to the latter years of the term, there is no showing that Redding has even bought capacity for those years yet; thus it cannot be found that it has been affected by the UEG's control of the secondary market for one month in 1998. The price rise does not show that the UEG's bidding strategy or later actions were anti-competitive.

With regard to the assertions that the bidding strategy influenced the price of Canadian gas and the value of PG&E's other transmission paths, no evidence was presented supporting those assertions, other than Cope's general testimony. We do not find it dispositive.

In sum, PG&E's bidding strategy may be fairly described as aggressively competitive. In making its bid, it took a risk that it would be unable to sell its later term capacity at the tariff price and would at that time be unable to recoup its transportation costs. This strategy did have the effect of limiting the pro-rata shares of other high bidders, but it did not in itself keep out the lower bidders – that would have happened anyway.

The UEG did dominate the secondary market for a short time. We remain concerned about such market domination and wish to address the problem through reforms in the auction procedures. The Gas Accord rules giving preference to full term bids clearly had a profound effect here. Those who feel that the amount of capacity should be capped for everyone can raise this issue in I.99-07-003. Especially given the disposition of the premiums, (see below), the UEG's short domination of the secondary market does not merit action by the Commission.

- **Did the UEG act in an anti-competitive manner by subsidizing other PG&E activities or reducing shareholder risk?**

CGC and others speculated that the 1998 low price of Canadian gas would not hold in the future, leading to a diminution of the relative value of Redwood Path capacity. For this reason, they claim, most buyers did not want to pay the full tariff rate for Redwood capacity for the full term. Additionally, they note, the UEG would not even have a use for most of the capacity in the latter years of the term. Therefore, they conclude, PG&E's UEG made its full term bid only in order to relieve its CGT and its shareholders of the risk that the capacity would not sell.

PG&E claims that their analysis led them to believe that Redwood capacity would retain tariff or higher value even though there might be short-term slumps during peak winter months and after expansion of Canadian pipelines. In order to ensure that it received low cost gas in the beginning of its term, it took the risk of buying for the full term. PG&E has now sold all of its capacity, although some may revert later in the Gas Accord term.

We fail to see what we are to make of this speculation. The UEG's bidding strategy undeniably relieved shareholders of the risk that the capacity would not be sold by the CGT. But the risk that the excess would not be sold by the UEG remained and the same shareholders are affected. Moreover, our holding in

D.98-07-092, slip op. at pp. 31-32, that only credits, not debits, could be transferred to the TCBA left the risk squarely with the shareholders.

As it turned out, the capacity was sold. The revenues in fact have not gone solely to shareholders. The $9 million premium that PG&E has garnered from its sale of excess capacity in the secondary market has been included in the weighted average cost of gas in the Must-Run Fossil Plant and Non-Must-Run Fossil Plant Memorandum Accounts, and its successor account. Any credit balances in these memorandum accounts have been and will be transferred to the TCBA and its successor account on an annual basis. Thus, PG&E's electricity ratepayers will receive benefit from the sale of excess intrastate pipeline capacity.

Recognizing that these revenues also aid in the elimination of any remaining transition costs that might fall to shareholders, we believe that this possible favorable outcome for PG&E was within the realm contemplated by the approval of D.98-07-092. TURN agreed that it was not a conflict of interest or a market advantage in the Open Season.

With regard to cross-subsidization, Enron and others claim that the risk that CGT might not sell its capacity was lessened when the UEG made such a high bid. PG&E replies that the risk was eliminated even without considering the UEG bid. Of course, PG&E's UEG could not know in advance that the CGT would be so successful, so this after-the-fact analysis does not shed any light on the reasons for its bidding strategy. Nevertheless, there is no evidence that CGT and the UEG acted in concert. Moreover, as noted by PG&E, there was no cross-subsidization because the capacity would have sold out without the bids of the UEG and its assignor.

- **What should be done?**

Calpine suggests divestiture of PG&E's intrastate backbone transmission system as a solution to abuses. In D.99-07-015, slip op. at p. 27 and p. 28, the

Commission stated that it was not convinced that divestiture of intrastate backbone transmission was a promising option as a response to the problems that arose in the Open Season auction. We noted the market control that large users like PG&E have even in a divested situation. Accordingly, this proposed remedy will not be implemented.

CIG/CMA asked that the UEG and cogenerators who submitted maximum bids get only the capacity they actually need and the remaining maximum bidders would get a higher percentage of the capacity they sought. In effect, that result has been achieved through the secondary market, albeit at a higher price than CIG/CMA wished. Again, we do not see the premium paid in the secondary market as necessitating a remedy, much less a penalty.

We do agree with Calpine and others that a change in the auction structure may well be needed. We noted our concern and asked for specific suggestions to be submitted in the cost-benefit phase of the Gas Strategy proceeding. (See D.99-07-015, slip op. at pp. 29-30.) Some of the ideas surfaced in Gas Strategy Phase I include: 1) letting the prices float rather than having a minimum bid; 2) having a cap on the percentage of capacity any one bidder and its affiliates or pre-arranged assignors can acquire; 3) having explicit rules for accounting with respect to any premium or loss from sales in the secondary market; and 4) having clearer instructions about the bid procedure and formula for value. We continue to welcome any other ideas for inclusion in our consideration of tradable rights on the secondary market in I.99-07-003.

With regard to the return of the benefit of the premium to electricity ratepayers, we decline to disturb that decision. It was made in February 1998, close in time to the actual conclusion of the auction and disclosure of the results.

TURN stipulated to this disposition. For the most part, the gas and electricity ratepayers are the same in the core residential group[11]. It would be unfair to unwind that decision in the context of this case as well as a violation of Pub. Util. Code § 1708.

We will not return premiums to other bidders. Such action would not help ratepayers, as TURN noted, but at this point would be a windfall to the shareholders or owners of the other bidders. Such a return of premium would not make the market more competitive. Moreover, those bidders could have pursued the same strategy; the UEG was acting as an aggressive competitor and risk-taker.

To the extent that CGC and Calpine seek to further expand this limited investigation of PG&E's bidding at the Open Season auction of Redwood Path capacity, we decline that invitation[12]. We do not wish to conduct a mid-term

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[11] As to the noncore PG&E gas customers, it is assumed that they have chosen noncore status because they are capable of protecting themselves from high prices by using other vendors.

[12] Thus, to the extent that CGC actually meant for us to consider an order regarding the Baja path (CGC Comments, Attachment A at p. 12), we will not do so within this limited investigation. Similarly, CGC's suggestion that PG&E should have more storage capacity and a related increase in rates is more appropriately addressed in a PG&E application.

PG&E's storage priority rule, about which Calpine complains, is simply not before us. Calpine's ideas about daily balancing have been addressed. We stated that daily balancing as an option -- not an order as suggested by Calpine -- will be considered in the next phase of the Gas Strategy proceeding. (D.99-07-015 at pp. 41-42.)

As to Calpine's suggestions about changing PG&E's tariff with regard to priority rights for transmission from storage, segmentation of existing paths to allow for releasing capacity at various points including identifying firm transportation delivery points for end-users directly connected to the backbone system, and an analysis of whether PG&E follows all Gas Industry Standard Board conventions, we also believe that these issues

Footnote continued on next page

review of the Gas Accord per se, as CGC and Calpine suggest. The frailties of the Gas Accord are undoubtedly being discussed as part of the settlement negotiations in I.99-07-003 (Phase II of the Gas Strategy proceeding). If that case is not settled, testimony concerning the weaknesses of the Gas Accord will be relevant to our investigation into creating secondary markets and a new paradigm for SoCalGas' participation in the market. PG&E's operations with regard to Operational Flow Orders and Emergency Flow Orders were discussed and analyzed in D.99-07-015, slip op. at pp. 30-35 and pp. 40-41. Certain aspects of PG&E's balancing practices are an explicit part of the next phase of the Gas Strategy proceeding. (See D.99-07-015, Conclusions of Law 6, 8, and 9, slip op. at p. 142.) CGC's evidence of escalating intrastate transportation costs will also be appropriate in I.99-07-013 to the extent that it illuminates where increasing costs are accruing and how restructuring might diminish those costs.

Conclusion

The bidding strategy of PG&E's UEG and the result of that strategy raised some legitimate concerns that needed investigation. After investigation, we have determined that the UEG did not behave in an anti-competitive manner warranting penalty. The auction procedures should be reformed to further limit the ability of any single entity to unduly influence the market. Enron's original motion for information is moot.

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are more appropriate in another proceeding. We suggest that they be discussed in the settlement negotiations in I.99-07-003.

Comments on Draft Decision

The ALJ's draft decision in this matter was mailed to the parties in accordance with Pub.Util.Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. Comments were received from Calpine, TURN, and PG&E. No significant changes were made in response to the comments. In the unique circumstances here, we do not agree with Calpine's assignment of error.

Findings of Fact

1. Enron has received the information it initially requested in its February 24, 1998 emergency motion.

2. The Commission has conducted an investigation of the allegations regarding anti-competitive actions on the part of PG&E's UEG during the Open Season auction for capacity on the Redwood Path.

3. PG&E's UEG bid for all the available capacity for the full term at the full tariff rate. It also arranged to take assignment of a portion of the capacity received by another bidder making the same bid.

4. The UEG did not make this bid in concert with PG&E's CGT, the seller of the capacity. It did not violate the affiliate transaction rules.

5. All credit-worthy entities with sufficient capital had the ability to make the same bid under the Gas Accord rules.

6. PG&E's January 16, 1998 memorandum to potential bidders indicated the exact formula and procedures PG&E would use in calculating value of bids. This memorandum made it clear that the primary determinants of value were length of term and reservation rate, not quantity.

7. PG&E's UEG did not violate the Gas Accord or its rules in making its bid or in pre-arranging an assignment.

8. After receiving notice of the UEG's bid, some cogenerators bid for all the available capacity for the full term at the full tariff rate.

9. The notice received by cogenerators was adequate and served its purpose.

10. Through its pro rata share and the pre-arranged assignment, PG&E's UEG ultimately received roughly 60% of the total available capacity for the first year of the term.

11. The capacity would have virtually sold out at the full tariff for the full term without the bids of the UEG and the pre-arranged assignor.

12. Even considering the pro rata diminution of shares, the UEG's bidding behavior under these circumstances was not anti-competitive.

13. PG&E's shareholders were at risk for the cost of capacity that was not used or sold, pursuant to D.98-07-092.

14. PG&E's UEG sold about half the capacity it acquired in the Open Season in the secondary market within the first month following the auction and before the inception of the Gas Accord term. Its remaining capacity was close to the capacity its generators required at the time.

15. PG&E's UEG sold all its excess capacity by April 1, 1999, although some may revert at a later date.

16. The short-lived market power in the secondary market does not warrant action by the Commission.

17. The premium over purchase price obtained by the UEG, approximately $9 million, has been applied to the TCBA.

18. This application benefits electricity ratepayers as well as ultimately benefiting shareholders by accelerating the recovery of transition costs.

19. The sale of excess capacity at a premium eliminated PG&E shareholder risk for transportation as a cost of generation. Sale at a premium was not foreseeable, especially for the latter part of the term.

20. By securing the capacity, the UEG gave PG&E's ratepayers the benefit of the lower cost gas from the Canada coming from Malin on the Redwood Path for the period of time that the UEG used the capacity.

21. The benefit accrued by PG&E shareholders in this situation is not a conflict of interest or otherwise anti-competitive.

Conclusions of Law

1. Enron's Emergency Motion should be denied as moot.

2. In I.99-07-003, problems with the Open Season auction for intrastate transmission capacity should be addressed for the primary and the secondary market by crafting new rules for the future.

3. This investigation into the open season auction within this docket should be closed without further action.

ORDER

Accordingly, **IT IS ORDERED** that:

1. The emergency motion filed by Enron Capital & Trade Resources and Enron Energy Services is denied as moot.

2. No penalty imposition or other action on the part of the Commission is required in this docket. Further discussion of potential reforms to auction rules for intrastate transmission capacity and for sales in the secondary market may take place within Investigation 99-07-003.

3. This investigation into the open season auction is closed. This docket remains open.

This order is effective today.

Dated November 18, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
JOEL Z. HYATT
CARL W. WOOD
Commissioners