From: Redacted

Sent: 3/2/2012 1:37:07 PM

To: Sabino, Pearlie Z. (pearlie.sabino@cpuc.ca.gov) (pearlie.sabino@cpuc.ca.gov); Peck, David B. (david.peck@cpuc.ca.gov) (david.peck@cpuc.ca.gov); Pocta, Robert M. (robert.pocta@cpuc.ca.gov) (robert.pocta@cpuc.ca.gov)

Cc: Doll, Laura (/O=PG&E/OU=CORPORATE/CN=RECIPIENTS/CN=LRDD); Clare, David (/O=PG&E/OU=Corporate/cn=Recipients/cn=DWC3); Redacted Redacted

Bcc:

Subject: Follow-up to Feb 16th meeting with PG&E

Dave, Mark and Pearlie:

During our meeting on February 16th, you inquired about documents verifying the existing CPIM sequence. A fully detailed description of the sequence showing the movement of each segment in response to index changes is not in the regulatory record. However, in our October 27, 2011 reply to DRA's protest, we provided two references from the record describing key elements relating to the existing one-month lag and the three-month sequence approach. Both references are from R.02-06-041 (June 27, 2002, Phase II), the rulemaking requiring preservation of pipeline capacity to California.

During the course of that proceeding, DRA and PG&E met to modify the CPIM benchmark sequence to include San Juan supplies delivered via Transwestern Pipeline (Transwestern) and El Paso Natural Gas (El Paso). PG&E's Reply Brief in the proceeding refers to this collaborative effort by PG&E and DRA (filed July 28, 2003):

> In accordance with the last bullet point on the first page of Ex. 1, representatives of PG&E and ORA have collaboratively agreed on revisions to the sequencing methodology to reflect the full integration of Transwestern and El Paso capacity. A copy of the agreed-upon sequencing is attached to these comments. They should be ratified by the Commission as part of the Ex. 1 agreements, and as an appropriate part of the Core Procurement Incentive Mechanism.

The resulting DRA-PG&E Agreement became Exhibit (Ex.) 1 in R.02-06-041, Phase II. PG&E described the agreed upon modifications on pages 9 and 10 of its Opening Brief, dated July 7, 2003. The modifications established a least cost sequence that recognized the timing of purchases compared to the publication of indices. The modifications also recognized the challenges surrounding the differences in index formulation between Canada and the US Southwest, with Canadian index formation during the entire preceding month, and US index formation exclusively during bid week, as we described in our meeting on February 16th. In addition, the DRA-PG&E Agreement delayed benchmark basin switching from index changes by one month. This delay is what we have referred to as the "one-month lag" during our recent discussions. The following is an excerpt from the DRA-PG&E Agreement:

- PG&E and ORA agree to collaborate on revisions to the sequencing methodology to reflect the full integration of Transwestern and El Paso capacity. While generally premised on least-cost, the methodology will take into account operational considerations, the need to maintain a portfolio which includes amounts of term and baseloaded supplies that can not be immediately unwound and reflects the fact that because the gas is purchased prior to the publication of the indices (first week of the month during which the gas flows), ***basin switching can not take place until the following month*** [emphasis added].

Further, attachment pages A1 and A2 in PG&E's Reply Brief in R.02-06-041 provide an elaboration appended to the above referenced DRA-PG&E Agreement. The third paragraph from that elaboration describes how the benchmark sequence responds to a price reversal between Alberta and San Juan, in which the lowest price shifts from one basin to the next. The document specifies that the sequence change is accomplished by shifting one-third of the supplies from each basin each month in response to index changes:

- Basin Switching Adjustments: The original Gas Accord CPIM contains provisions allowing for a gradual adjustment to the benchmark sequence when there is a reversal in the relative prices between Alberta and Topock. The revised CPIM will replace the earlier methodology with a similar process that is triggered when a price reversal occurs between Alberta and San Juan. The change in the benchmark sequence resulting from a basin-price reversal between these two basins will transition over a three-month period. ***In the first month after the basin-price reversal is known to have occurred***, the benchmark will sequence 33% of lower cost path before the more expensive path; in the second month the benchmark will sequence 66% of the lower cost path before the more expensive cost path and in the third month 100% of the lower cost path will be sequenced ahead of the other path. A similar thirty-three percent (33%) per month transition will be used if the prices shift again in the opposite direction [emphasis added].

These modifications clearly specify a gradual change to the benchmark sequence over a three-month period, with the response to basin price changes occurring ***after*** index publication. PG&E's current proposal to sequence Rocky Mountain supplies continues to use price index data published before baseload purchasing occurs, in keeping with the one-month lag. It also retains the three-month sequence approach to manage index relationship changes between the three basins in a manner consistent with past agreement by DRA and PG&E, and in keeping with actual past operational practices.

Finally, to reiterate what we discussed during our last meeting, the gradual benchmark change over a three month period coupled with the one-month lag enables PG&E's Core Gas Supply to stagger its gas purchases over multiple months. Spreading transactions over a longer period of time provides dispersed demand signals to the market which may help keep prices lower in high demand months, while minimizing credit concerns of PG&E and our suppliers by providing opportunities for capacity release in advance of index formation.

For your convenience, I have attached the referenced PG&E Opening and Reply Briefs containing the CPIM modifications agreed to by DRA and PG&E. The third file is D. 04-01-

047, the Commission's decision which adopted the DRA-PG&E stipulations, including the CPIM modifications (FOF 12). I hope this information helps. We look forward to meeting with you on March 8th to resolve this issue.

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Manager, Regulatory and Contract Services

Core Gas Supply

Pacific Gas and Electric Company

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