

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Require
California Natural Gas and Electric
Utilities to Preserve Interstate Pipeline
Capacity to California.

Rulemaking 02-06-041
(Filed June 27, 2002)
(Phase 2)

**OPENING BRIEF OF PACIFIC GAS AND ELECTRIC COMPANY (U 39 G)
ON PHASE II ISSUES**

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Phase II of this proceeding arises from the requirements of Decision 02-07-037, which ordered the major California energy utilities to acquire capacity on El Paso Natural Gas Company's (El Paso) interstate pipeline system, in response to concerns that the capacity may be lost to out-of-state utilities, marketers and end-users. Decision 02-07-037, at mimeo pages 21-23, and the December 26, 2002 "Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge for Phase II of This Proceeding," at mimeo pages 2-5, set the following issues for Phase II:

1. Whether the utilities have fully complied with Decision 02-07-037 in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated in that decision;
2. How the costs of turned-back capacity and pre-existing capacity rights on interstate pipelines should be allocated among utility customers and the appropriate mechanisms for recovery in rates of those costs;
3. Any appropriate adjustments to a utility's gas cost incentive mechanism to properly account for both existing and recently-acquired interstate capacity;
4. The appropriate date that the utilities can begin recovering the costs associated with their subscription to turned-back capacity, as well as costs associated with

their pre-existing capacity rights on interstate pipelines, to the extent that utilities have complied with Decision 02-07-037.

5. Whether and how short-term capacity releases of interstate capacity (in excess of the utilities' need) should be allowed; and

6. The criteria under which the Commission should authorize adjustments to interstate capacity holdings or long-term capacity releases.

In addition, on April 17, 2003, the Commission adopted Decision 03-04-061, which granted The Utility Reform Network (TURN) and any other parties an opportunity to be heard on the issue of recovery by the utilities of existing gas transmission subscription costs.

During the course of the proceeding, Pacific Gas and Electric Company (PG&E) entered into two stipulations, one with the Office of Ratepayer Advocates (ORA), which became Exhibit (Ex.) 1, and one with TURN, which became Ex. TW-102, which would reasonably resolve all of the issues identified by the Commission that are specific to PG&E. In summary, the two stipulations resolve the issues as follows:

1. PG&E has fully complied with Decision 02-07-037 in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated in that decision;
2. The El Paso capacity and pre-existing Transwestern Pipeline Company (Transwestern) capacity rights are held for the benefit of core gas customers and are fully recoverable in core rates in a manner analogous to the recovery of PG&E's other interstate capacities held for the core;
3. Ex. 1 lists the adjustments to PG&E's Core Procurement Incentive Mechanism (CPIM) that should be made to accommodate the new El Paso capacity and the changed status of the Transwestern capacity;
4. PG&E will recover its El Paso costs from its core procurement customers, in accordance with Ex. 1. El Paso costs are currently being recovered from all customers on an equal-cents-per-therm basis in accordance with Resolution G-3339, issued December 19, 2002, subject to reallocation after the decision in

this phase of the proceeding. In accordance with Ex. TW-102, PG&E will begin full recovery of its Transwestern costs from its core ratepayers effective as of July 1, 2003.¹ The reallocation of costs between customers for El Paso costs and the full recovery of Transwestern costs will be made in a compliance advice filing following the effective date of a decision in Phase II;

5. Short-term releases of both the El Paso and Transwestern capacity are permitted without restriction and at PG&E's discretion and judgment whenever the capacity is not needed for the benefit of core customers. Revenues from brokering of the El Paso capacity after October 31, 2002, and from the Transwestern capacity after June 30, 2003, will be used to directly offset core gas costs;
6. PG&E should not have explicit restrictions on its ability to modify or change the amount of interstate capacity it holds for its core customers. Ex. 1 establishes procedures for PG&E/ORA collaboration on whether capacity contracts should be renewed or increased, and for Commission concurrence of any recommendations.
7. Both Exs. 1 and TW-102 concur that PG&E's holding of Transwestern capacity for the benefit of core customers is reasonable.

Given the two stipulations with PG&E's two main protagonists, there is only one issue between PG&E and any party in this proceeding, and a contingent issue raised by TURN. In Ex. 39, TURN supports the allocation of El Paso capacity costs to PG&E's core customers, consistent with Ex. 1, but only if the Commission does not adopt an equal-cents-per-therm methodology as its base policy. The other issue is the proposal of the Southern California Generation Coalition (SCGC), in Ex. 44, to unilaterally allocate some of

¹ To the extent that the PG&E/TURN stipulation moves the effective date for full recovery of Transwestern to a later date than that contemplated in the PG&E/ORA stipulation, the PG&E/TURN stipulation supercedes and replaces that part of the PG&E/ORA stipulation.

SoCalGas' capacity to the other California energy utilities, including PG&E. TURN's contingent issue should not be a problem, and SCGC's proposal should not be adopted.

I. BACKGROUND AND HISTORY

On June 27, 2002, the Commission issued an Order Instituting Rulemaking (R. 02-06-041) proposing to require California's natural gas utilities, PG&E, Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Southwest Gas Corporation (Southwest), and the largest electric utilities, PG&E, SDG&E and Southern California Edison Company (Edison) to sign up for as much as possible of 725 million cubic feet per day (MMcf/d) of firm capacity on the El Paso system that was eligible to be turned-back by marketers currently serving California, pursuant to orders issued by the Federal Energy Regulatory Commission (FERC). The Commission was concerned that if the capacity was not acquired by California utilities, California could permanently lose the 725 MMcf/d to El Paso's East-of-California (EOC) customers.

After receiving comments, the Commission issued Decision 02-07-037 on July 25, 2002, requiring the named utilities to sign up for turned-back capacity on the El Paso system. The Decision stated an expectation that PG&E and SoCalGas would each sign up for at least 200 MMcf/d (or 67%) of the turned-back capacity at their respective delivery points, and that Edison, SDG&E and Southwest would sign up for most of the remaining 100 MMcf/day at the Southern California delivery points. Decision 02-07-037, at mimeo pages 18-19. To the extent that the utilities complied with the Decision, the Commission found that the utilities should be guaranteed cost recovery for both the subscriptions for El Paso capacity and the costs associated with existing capacity rights on other interstate pipelines. Decision 02-07-037, Ordering Paragraphs 2 and 3. The Decision also established a Phase II of the proceeding to consider cost allocation of the capacity costs, noting that: "each utility's costs associated with acquiring turned back capacity will be recovered in its own customers' rates and the allocation between core and noncore customers, and gas and electric operations, may differ by utility depending on the utility's specific situation." Decision 02-07-037, at mimeo

page 21. Phase II was also assigned issues relating to capacity releases and necessary adjustments to core procurement incentive mechanisms.

In compliance with the decision, PG&E acquired 203,532 MMBtu/d² of capacity on the El Paso system, effective November 1, 2002: 40,000 MMBtu/d through a turnback award and 163,532 MMBtu/d through two assignments of capacity from shippers to California, with a portion of the acquisition at rates significantly less than El Paso's maximum tariff rates. PG&E's October 15, 2002, Compliance Report.

PG&E began recovering both its El Paso costs (including prepayments required for acquisition of the El Paso capacity) and the Transwestern capacity costs that were not otherwise being recovered through the CPIM from its core customers³, beginning with the monthly core procurement advice filing effective on August 7, 2002. ORA protested each of PG&E's monthly filings, arguing that PG&E's allocation to its core customers and collection of its Transwestern costs beyond those already permitted by PG&E's CPIM were premature and needed to await the outcome of Phase II. In Resolution G-3339, adopted December 19, 2002, the Commission agreed with the ORA and authorized PG&E to recover from its ratepayers the costs it incurs for the El Paso capacity, to be collected on an equal-cents-per-therm basis from both core and noncore customers, on an interim basis pending the cost allocation issues to be decided in this Phase II. The Resolution also ordered PG&E to continue to collect only the Transwestern charges authorized for collection from core procurement ratepayers under the CPIM, pending the outcome of Phase II. PG&E was required to reallocate the El Paso charges it included in its core procurement rates to its core and noncore ratepayers on an equal-cents-per-therm basis and return revenues collected in excess of the CPIM-authorized revenues for Transwestern charges. The Resolution also found that PG&E has met the objectives, terms and conditions set in Decision 02-07-037 and

² Although it can fluctuate slightly, there are about 1030 Mbtu in one Mcf of gas from the Southwest.

³ The post-1997 CPIM permits PG&E to recover Transwestern capacity demand charges to the extent the capacity is sequenced for the core. Ex. 30 (PG&E), Chapter 2, Appendix 2-1, Appendix 1, page 8.

therefore had met the conditions for recovery of existing and acquired capacity. Resolution G-3339, at mimeo pages 9-10, Finding 17, and Ordering Paragraphs 1-6.

In compliance with Resolution G-3339, PG&E submitted Advice 2434-G on December 30, 2002, making the changes to PG&E's tariffs to implement the requirements of Resolution G-3339, and establishing, effective December 19, 2002, balancing accounts to track the El Paso and Transwestern charges subject to cost allocation in this Phase II. Advice 2434-G was accepted for filing, effective December 19, 2002, in a letter from the chief of the Energy Division, dated February 24, 2003. Ex. TW-104 (PG&E). PG&E also filed Advice 2437-G on January 8, 2003, in further compliance with Resolution G-3339, that revised core and noncore transportation rates to begin recovery, on an equal-cents-per-therm basis, of the costs associated with the El Paso capacity, subject to the outcome of Phase II of this proceeding. Advice 2437-G was approved by Energy Division letter effective March 2003.⁴

Meanwhile, TURN had filed an application for rehearing of Decision 02-07-037, alleging that the portion of the decision authorizing recovery of costs for existing interstate capacity if a utility acquired additional El Paso capacity in compliance with Decision 02-07-037, was adopted without adequate notice or an opportunity to be heard. In Decision 03-04-061, the Commission granted TURN a rehearing and provided an opportunity for additional comments by the parties on the issue of recovery of existing gas transmission subscription costs, including the Transwestern subscription costs not currently recovered through the CPIM.

Testimony was submitted on February 7, March 21 and April 4, 2003. Several parties submitted prepared testimony, including SoCalGas and SDG&E (Exs. 3, 4, and 5); Edison (Exs. 6-9); Southwest (Exs. 11-12); PG&E (Exs. 30-32); ORA (Exs. 36-37); TURN (Exs. 38-39); the California Manufacturing and Technology Association, Calpine, Duke, Mirant, Watson and West Coast corporations (jointly CMTA) (Exs. 42 and 43); and SCGC (Ex. 44).

⁴ The noncore transportation rate change approved in Advice 2437-G became effective March 1, 2003. The core transportation rate change became effective March 7, 2003, in conjunction with PG&E's monthly core procurement rate change.

In addition, the Northern California Generation Coalition submitted a letter supporting the testimony of PG&E in lieu of its own testimony. On the rehearing issue, only PG&E and TURN participated, with each submitting testimony, Ex. TW-100 for PG&E, and TW-101 for TURN.

Hearings were held April 28 through May 1, 2003, with an extra day of hearing on June 19th on the rehearing issue. Just prior to the first set of hearings, PG&E and ORA entered into a stipulation (Ex. 1) resolving all issues between them. And just prior to the hearing on the Transwestern rehearing issue, PG&E and TURN entered into a stipulation (Ex. TW-102) resolving all issues between them.

II. RESOLUTION OF THE ISSUES

A. **Issue 1 - Whether the utilities have fully complied with Decision 02-07-037 in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated in that decision.**

This has become a non-issue in this proceeding. The Commission has already found that PG&E has met the objectives, terms and conditions set in Decision 02-07-037 regarding El Paso pipeline capacity quantities and pricing terms, and therefore has met the conditions for recovery of existing and acquired capacity, in Resolution G-3339, at mimeo pages 9-10 and Finding 17. In fact, no party has alleged that *any* utility has not fully complied with the requirements of Decision 02-07-037 in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated in the decision.

B. **Issue 2 - How the costs of turned-back capacity and pre-existing capacity rights on interstate pipelines should be allocated among utility customers and the appropriate mechanisms for recovery in rates of those costs.**

This has become a non-issue for all utilities except SoCalGas. PG&E proposed that its acquired El Paso capacity and pre-existing Transwestern capacity be held for the benefit of its core customers, with the costs accordingly allocated to them. PG&E extensively discussed why the capacity should be held for the core. Ex. 30, pages 1-7 to 1-12 and 2-1 to

2-13; Ex. 31, pages 2-1 to 2-13. The only party taking an active position opposing a full allocation of El Paso costs to the core was the ORA, but in Ex. 1, the Stipulation and Agreement between ORA and PG&E, ORA also agreed that the El Paso and Transwestern capacity costs are held for the benefit of core gas customers and should be fully recoverable in core rates in a manner analogous to the recovery of PG&E's other interstate capacities held for the core.

Even TURN agrees that it makes sense for PG&E's core to hold firm capacity rights on the El Paso system. Ex. 39, pages 4-6. TURN's only caveat is that if the Commission adopts equal-cents-per-therm as its policy for allocating the costs of the newly-acquired El Paso capacity, TURN would recommend adoption of ORA's original proposal, which ORA abandoned in its Ex. 1 agreement. In any event, the Commission should not adopt equal-cents-per-therm as a policy, particularly since there is unanimous support for full allocation to the core for PG&E, SDG&E, and Southwest.

With regard to the other utilities, there is unanimous support for cost allocation to core ratepayers for the El Paso capacity acquired for Southwest and SDG&E, a position which PG&E supports. There is also unanimous support for Edison allocating its El Paso capacity costs to all of its electric customers, which PG&E also supports. The only entity for which cost allocation is an actual issue is SoCalGas, with proposals ranging from all costs assigned to the noncore (Ex. 38 (TURN), p. 5) to all costs assigned to the core (Ex. 42 (CMTA), pp. 12-13). There are enough interested parties who care passionately about the issue to fully illuminate it, so PG&E has no position on the appropriate cost allocation for SoCalGas.

C. Issue 3 - Appropriate adjustments to a utility's gas cost incentive mechanism to properly account for both existing and recently-acquired interstate capacity.

PG&E proposed appropriate adjustments to its CPIM to account for the addition of both existing and recently-acquired interstate capacity to its core portfolio. Ex. 30, pp. 2-13 to 2-17 and Chapter 3. The stipulation and agreement with ORA in Ex. 1 specifies both the

adjustments and the processes that should be adopted to properly account for the El Paso and Transwestern capacity. They are reproduced in full below:

- The modifications to the Core Procurement Incentive Mechanism (CPIM) that should be made to accommodate the new El Paso capacity and the changed status of the Transwestern capacity are:
 - PG&E will be authorized to engage in sales of natural gas in the wholesale market within California, consistent with its ability to sell gas outside of the state or at the California border, as outlined in PG&E's recent Advice Letter Filing (2441-G). ORA will withdraw its protest of Advice Letter 2441-G.
 - All costs for existing interstate transportation and storage (including Transwestern) will be included in the CPIM mechanism.
 - The annual PG&E shareholder award will be capped at the lower of 1.5% of total annual gas commodity costs or a "hard cap" limiting the total annual shareholder award to \$25 million.
 - PG&E and ORA will meet at least annually (more often, if needed) to discuss the need for additional capacity acquisition for the upcoming CPIM period.
 - 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.
 - All existing El Paso and Transwestern capacity will be allocated to core customers for the duration of the contracts. As the El Paso contracts expire, ORA and PG&E agree to meet and confer and seek CPUC concurrence as to whether the contracts should be renewed at the full tariff rate, consistent with the FERC ROFR rights under the existing contracts. "Existing" capacity to be defined as capacity contracts as of January 2004, excluding renewals. ORA and PG&E agree to meet and confer as to whether contracts subject to renewal after January 2004, should be renewed for the core as noted above. The CPIM winter withdrawal schedule (November-March) will be based on the November 1 storage inventory allocated to the bundled core customers (33.5 MMDth adjusted for any allocation of storage to the Core Transport Agents) minus 2.5 MMDth. PG&E's obligation to fill core storage for the winter remains unchanged.
 - Revenues from brokered interstate and intrastate transportation capacity will be used to directly offset core gas costs under CPIM.
 - PG&E and ORA will meet collaboratively to discuss whether annual Baja capacity holdings should be adjusted to match the upstream firm interstate capacity. ORA and PG&E will make a joint recommendation to the

Commission regarding the matching of Baja capacity with the upstream firm interstate capacity in 2004.

- The changes outlined in this agreement will be effective for the current CPIM year beginning November 1, 2002. The CPIM will continue until either ORA or PG&E proposes modifications and those modifications are approved by the Commission.
- The Kingsgate index in the CPIM sequence will be modified to use the AEEO index net forward to Kingsgate, as described in George Clavier's testimony [Ex. 30, p 2-17].

- Sharing Modifications:
 - A. Savings (below the benchmark costs) to be shared as follows:
0-1% RP 100%
1+ % RP 75%/SH 25%
 - B. Above tolerance band sharing to remain as 50% RP/50% SH consistent with the existing CPIM.

All other aspects of the current CPIM will remain unchanged.

The agreed-upon modifications are uncontested, make sense, and will keep the CPIM a working mechanism for the coming years.

D. Issue 4 - The appropriate date that the utilities can begin recovering the costs associated with their subscription to turned-back capacity, as well as costs associated with their pre-existing capacity rights on interstate pipelines.

With the two Stipulation and Agreements between PG&E and first ORA, then TURN, there is complete agreement on the appropriate dates for beginning recovery of the costs of the newly-acquired El Paso capacity and the full cost of the Transwestern capacity.

Pursuant to Resolution G-3339, PG&E has been recovering the costs of its El Paso capacity from both core and noncore ratepayers, on an equal-cents-per-therm basis. Ex. 1 stipulates that the El Paso capacity is held for the core, so all of the costs collected to date should be reallocated to core customers. For the Transwestern capacity, the PG&E/TURN stipulation contemplates July 1, 2003, as the date to begin recovery of all Transwestern

⁵ PG&E intends that the PG&E/TURN agreement supercede the PG&E/ORA agreement with respect to recovery of Transwestern costs. By moving the date back eight months, core ratepayers will pay less, and PG&E shareholders more by approximately \$600,000, so it is unlikely ORA will object to the change.

costs.⁵ Once a decision is issued in Phase II of this proceeding, PG&E proposes to make a compliance Advice filing to propose the rate changes and balancing account adjustments necessary to reallocate El Paso costs from core and noncore transportation rates to core procurement rates, and to fully recover Transwestern costs through core procurement rates.

E. Issue 5 - Whether and how short-term capacity releases of interstate capacity (in excess of the utilities' need) should be allowed.

This is another non-issue. All parties support the ability of the utilities to make short-term capacity releases (in excess of the utilities' need) to maximize the use of the capacity and generate revenue to offset core capacity costs. Because these are short-term transactions, the utilities must have the ability and discretion to make the transaction when the appropriate opportunity arises. The agreement and stipulation with ORA, Ex. 1, addresses how brokering revenues are to be handled on PG&E's system after Commission adoption of the principles contained in the agreements: "Revenues from brokered interstate and intrastate transportation capacity will be used to directly offset core gas costs under CPIM." The revenues will be credited back to the customers paying for the capacity in the same manner as the recovery of PG&E's other interstate capacities held for the core. Ex. 30, pages 3-4 to 3-7.

F. Issue 6 - The criteria under which the Commission should authorize adjustments to interstate capacity holdings or long-term capacity releases.

The need for interstate capacity is a changing and dynamic situation. Setting hard and fast rules about the amount of capacity a utility will need at some time in the future would, like most predictions of the future, almost certainly be wrong. Instead, the PG&E/ORA Stipulation and Agreement in several places establishes processes to

⁵ PG&E intends that the PG&E/TURN agreement supercede the PG&E/ORA agreement with respect to recovery of Transwestern costs. By moving the date back eight months, core ratepayers will pay less, and PG&E shareholders more by approximately \$600,000, so it is unlikely ORA will object to the change.

intelligently and collaboratively address the issues as they arise. Specifically, Ex. 1 agrees that:

- ORA and PG&E agree to meet and confer as to whether contracts for El Paso capacity that are subject to renewal after January 2004, should be renewed for the core.
- PG&E and ORA will meet at least annually (more often, if needed) to discuss the need for additional capacity acquisition for the upcoming CPIM period.
- PG&E and ORA will meet collaboratively to discuss whether annual Baja capacity holdings should be adjusted to match the upstream firm interstate capacity. ORA and PG&E will make a joint recommendation to the Commission regarding the matching of Baja capacity with the upstream firm interstate capacity in 2004.
- The changes outlined in this agreement will be effective for the current CPIM year beginning November 1, 2002. The CPIM will continue until either ORA or PG&E proposes modifications and those modifications are approved by the Commission.

The agreement provides for a collaborative process for determining whether more or less interstate capacity is needed in the future, for adjustments to intrastate capacity to match the interstate capacity, and for Commission approval of any recommended changes. It is a process that is reasonable for determining long-term changes to interstate capacity holdings, and should be adopted for PG&E.

G. Issue 7 – Recovery of Transwestern Capacity Costs Not Currently Recovered Under the CPIM

Ordering Paragraph 3 of Decision 02-07-037 states: “To the extent that the California utilities comply with these Rules and this Opinion, they shall also receive full cost recovery for their costs associated with their existing capacity rights on interstate pipelines.” The only situation to which this Ordering Paragraph applies which anyone has identified is PG&E’s subscription to Transwestern capacity. In Decision 95-12-046, the Commission found that PG&E’s 1992 subscription to Transwestern capacity was unreasonable, largely because PG&E’s interstate pipeline capacity holdings at the time it acquired the Transwestern capacity exceeded the intrastate capacity available to get the gas to customers. In 1997, the

Commission agreed to permit Transwestern costs to be recovered from core customers, to the extent that the core used the capacity, as part of the post-1997 CPIM mechanism approved in Decision 97-08-055. ORA agrees that the 150 MDth/d of Transwestern capacity should be held for the benefit of core gas customers and should be fully recoverable in core procurement rates. Ex. 1. The last hurdle was satisfying the requirements of Decision 03-04-061, which provided another opportunity to be heard on the “all existing interstate capacity is also reasonable” finding of Decision 02-07-037.

PG&E submitted testimony (Ex. TW-100), as did TURN (Ex. TW-101). No other party submitted testimony or appeared at the hearing. PG&E’s testimony explained the context in which the Commission found the capacity acquisition unreasonable in 1992, and how circumstances have changed since then. It quantified the tangible benefits that the Transwestern capacity has provided in the recent past and could continue to provide in the future, and points out that it should be treated no differently than other capacity PG&E holds for the benefit of its core customers. As a result of the respective showings of PG&E and TURN, and discussions between them, PG&E and TURN came to an agreement on how Transwestern capacity should be addressed in this proceeding. The agreement, Ex. TW-102, contains the following terms:

- TURN agrees that it has been given the notice and opportunity to be heard on Transwestern capacity issues afforded by Decision 03-04-061.
- TURN and PG&E agree that PG&E’s current holding of capacity on the Transwestern Pipeline Company system is reasonable.
- The 150 MDth/d of Transwestern capacity will be held for the benefit of core gas customers. Core customers will be fully responsible for payment for the capacity costs in Core Procurement Rates, commencing July 1, 2003, for the duration of the contracts. Brokering revenues from the brokering of the capacity when it is not needed for core service will be credited back to Core Procurement commodity costs.
- Prior to July 1, 2003, PG&E will recover Transwestern capacity costs in accordance with the provisions of the currently-effective Core Procurement Incentive Mechanism (CPIM).

PG&E, in its Ex. TW-100, discussed the requirements set forth in Decision 95-12-046 and requested modification of the Decision to the extent necessary to permit it to fully

recover its Transwestern costs commencing July 1, 2003.⁶ The active parties representing small ratepayer interests, ORA and TURN, both concur that PG&E's current holding of capacity on the Transwestern system is reasonable, is held for the benefit of core gas customers, and should be fully recoverable from those customers. The Commission should make the same finding.

III. THE COMMISSION SHOULD NOT UNILATERALLY REALLOCATE SOCALGAS CAPACITY TO OTHER UTILITIES

This is an issue that originally began with a recommendation in SCGC's testimony (Ex. 44) that alleges that PG&E and SDG&E have too little Southwest interstate capacity, that SoCalGas has too much Southwest interstate capacity, and that PG&E and SDG&E should take a direct assignment of a portion of SoCalGas' capacity holdings "to the extent that those utilities need additional capacity to serve core customers" (Ex. 44 (SCGC), page 4), notwithstanding the fact that an identical proposal was already considered and rejected in Decision 02-07-037, at mimeo pages 19-20. During the course of the hearings in this proceeding, cross-examination by SCGC's counsel appeared to indicate SCGC's proposal was evolving into one where PG&E would allow some of its El Paso capacity contracts to expire and be replaced by "excess" SoCalGas capacity. See, e.g., Transcript (Tr.) pages 433-435 (SCGC's counsel, Pederson, asking questions of TURN's witness Florio).

SCGC's initial proposal is premised on two "facts:" SoCalGas has too much capacity and PG&E's core has too little.⁷ The first assumption is uncertain, and the second is not true. Decision 02-07-037 expressed an expectation that SoCalGas would acquire approximately 200 MMcf/d of new El Paso capacity; SoCalGas actually acquired 142 MDth/d. Ex. 3

⁶ Since PG&E is tracking these costs in a Commission-approved balancing account (Ex. TW-104), there can be no issue that approval of this date constitutes retroactive ratemaking. See, e.g., Decision 91-12-054, 42 CPUC 2d 415, at 419.

⁷ Since the proposal is primarily supported by noncore customers of SoCalGas who are often also noncore customers of PG&E, presumably these customers are worried that they will be required to pay at least a portion of SoCalGas' capacity charges. One assumes their enthusiasm would dampen if their proposal were approved, but the noncore customers of PG&E were required to pay the cost of the additional capacity.

(SoCalGas), page 2. SoCalGas' holdings of interstate capacity provided substantial benefits to its ratepayers during the winter of 2000/2001. Ex. 44 (SCGC), page 4. During the winter of 2000/2001, SoCalGas asserted that there was no excess capacity on its system. In Resolution G-3304, adopted December 21, 2000, at page 3, the Commission summarized SoCalGas' interstate capacity situation as follows:

“Currently, there is no excess interstate pipeline capacity serving Southern California. SoCalGas is utilizing all of the interstate pipeline capacity that it has reserved for the core (1,020 MMcf/d) on behalf of its existing core and core subscription customers. SoCalGas' noncore capacity released to the market (406 MMcf/d) is fully subscribed through at least October 2001, and SoCalGas asserts that there is little or no released capacity currently for sale to the Southern California market. Instead, those who hold interstate pipeline capacity rights are either bringing their own gas supplies in from the producing basins utilizing such rights or are selling natural gas commodity at the California-Arizona border.”

It is unclear whether SoCalGas currently has “excess” capacity.

As for PG&E, we have been clear throughout this proceeding that the 200 MDth/d of new capacity that PG&E acquired as a result of this proceeding was the right amount. In PG&E's July 12, 2002 Reply Comments to the original OIR, PG&E recommended, at page 8, that 150-200 MMcf/d of El Paso capacity was the right amount to serve core winter loads. PG&E's rebuttal testimony, in Ex. 31, particularly Chapter 2, spends much of its time rebutting the original assertion of ORA that PG&E now has too much interstate capacity. The fact is that holding capacity is good insurance against high demands and price spikes. But holding capacity costs money, and one always needs to use judgment in weighing the value of additional capacity against the price of that capacity and, all things considered, PG&E believes that it has about the right amount at the present time, under current market conditions. Ex. 31, page 1-6.

SCGC's contention that PG&E needs additional capacity is entirely based on a twelve-year-old forecast. Ex. 44 (SCGC), pages 3, 5 and 6; Tr. 470-472, 474 (SCGC, Yap). If SCGC had used the high-demand year forecast for PG&E from the 2002 California Gas

Report, SCGC would have had to acknowledge that PG&E's forecasted average daily core requirements ranged from 884 MMcf/d in 2002, to 918 MMcf/d in 2006 (Ex. 45). The 2002 California Gas Report forecasts for cold winters correspond closely to PG&E's current holding of 610 MDth/d of capacity on the pipeline to Canada, 150 MDth/d of capacity on Transwestern, and 203 MDth/d of capacity on El Paso, for a total of 963 MDth/d of interstate capacity. Of course, on a cold winter day demand will be greater than the annual average amount of demand, but PG&E's Core Procurement also holds 33.5 MMDth of firm storage capacity, which can provide an additional 1100 MDth/d of supply. PG&E can also buy additional gas at the California border, if necessary. On that peak winter day, additional marginal purchases of gas are likely to be expensive, but the individual days of expensive gas have to be compared to the annual cost of additional capacity. As PG&E has maintained all along, PG&E firmly believes that its current holdings, including the 203 MDth/d of El Paso capacity is the "right" amount today to meet the core requirements at least cost. PG&E should not be required to acquire additional capacity from SoCalGas.

SCGC's evolved alternative, that PG&E let its El Paso capacity contracts expire when their initial term is up and assume an equivalent amount of SoCalGas capacity would be acceptable to PG&E, if the acquired SoCalGas capacity was at least as good as PG&E's current capacity holding, in terms of the producing basins (the San Juan), the price, and the term of the contracts (shorter term, with renewal rights). But even if those hurdles were met, SCGC's alternative would require a substantial policy shift on the part of the Commission. Letting PG&E's contract(s) expire and taking on an equivalent amount of SoCalGas' capacity would result in a net reduction of capacity committed to California. Since the whole point of R. 02-06-041 was to preserve as much El Paso interstate capacity as possible, the Commission would have to determine that a total lesser amount of interstate capacity to California was acceptable. PG&E has seen no indication that the Commission is so inclined, and the recent submission of a proposed settlement between the Commission, El Paso, PG&E, Edison and the City of Los Angeles (Ex. 103) would make even more El Paso capacity available to California.

IV. CONCLUSION

Consistent with the record in this proceeding and with the Stipulations and Agreements reached between PG&E and ORA and PG&E and TURN, the Commission should adopt the following findings:

1. PG&E has fully complied with Decision 02-07-037 in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated in that decision;
2. The El Paso capacity and pre-existing Transwestern capacity rights are held for the benefit of core gas customers and are fully recoverable in core procurement rates in a manner analogous to the recovery of PG&E's other interstate capacities held for the core;
3. The adjustments to PG&E's Core Procurement Incentive Mechanism (CPIM) and processes listed in Ex. 1 should be made to accommodate the new El Paso capacity and the changed status of the Transwestern capacity;
4. PG&E will recover its El Paso costs from its core customers, in accordance with Ex. 1. PG&E will begin full recovery of its Transwestern costs from its core ratepayers effective as of July 1, 2003. The reallocation of El Paso costs between customers and full recovery of Transwestern costs will be made in a compliance advice filing to make the necessary rate changes and balancing account adjustments, following the issuance of a decision in this phase of the proceeding;
5. Short-term releases of both the El Paso and Transwestern capacity are permitted without restriction and at PG&E's discretion and judgment whenever the capacity is not needed for the benefit of core customers. Revenues from brokering of the El Paso capacity, and from the Transwestern capacity after June 30, 2003, will be used to directly offset core gas costs under PG&E's CPIM;

6. PG&E should not have explicit restrictions on its ability to modify or change the amount of interstate capacity it holds for its core customers. The procedures for PG&E/ORCA collaboration on whether capacity contracts should be renewed or increased, and for Commission concurrence of any recommendations identified in Ex. 1 should be adopted.
7. PG&E should not be required to assume any of SoCalGas' capacity.

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TABLE OF CONTENTS

	Page
I. BACKGROUND AND HISTORY.....	4
II. RESOLUTION OF THE ISSUES.....	7
A. Issue 1 - Whether the utilities have fully complied with Decision 02-07-037 in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated in that decision.....	7
B. Issue 2 - How the costs of turned-back capacity and pre-existing capacity rights on interstate pipelines should be allocated among utility customers and the appropriate mechanisms for recovery in rates of those costs.....	7
C. Issue 3 - Appropriate adjustments to a utility’s gas cost incentive mechanism to properly account for both existing and recently-acquired interstate capacity.....	9
D. Issue 4 - The appropriate date that the utilities can begin recovering the costs associated with their subscription to turned-back capacity, as well as costs associated with their pre-existing capacity rights on interstate pipelines.....	10
E. Issue 5 - Whether and how short-term capacity releases of interstate capacity (in excess of the utilities’ need) should be allowed.....	11
F. Issue 6 - The criteria under which the Commission should authorize adjustments to interstate capacity holdings or long-term capacity releases.....	12
G. Issue 7 – Recovery of Transwestern Capacity Costs Not Currently Recovered Under the CPIM.....	12
III. THE COMMISSION SHOULD NOT UNILATERALLY REALLOCATE SOCIALGAS CAPACITY TO OTHER UTILITIES.....	14
IV. CONCLUSION.....	17