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)**

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

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Pacific Gas and Electric Company (PG&E) received opening briefs from Calpine Corporation, Duke Energy North America, Mirant Americas, Inc., and Watson Cogeneration Company (jointly "Calpine et al."); the California Manufacturers and Technology Association (CMTA); The Utility Reform Network (TURN); the School Project for Utility Rate Reduction and the Association of Bay Area Governments Publicly Owned Energy Resources (jointly "SPURR"); Coral Energy Resources, L.P. (Coral); the Office of Ratepayer Advocates (ORA); a joint brief of Southern California Gas Company and San Diego Gas & Electric Company (jointly "Sempra"); Southern California Edison Company (SCE); and the Southern California Generation Coalition (SCGC). As expected (and hoped for), no party has taken any position inconsistent with the two stipulations and agreements reached between PG&E and ORA (Exhibit (Ex.) 1), and PG&E and TURN (Ex. TW-102). The agreements embodied in both exhibits should be adopted without modification.

Only two briefs, those of SCGC and SPURR, make recommendations with which PG&E takes issue – SCGC's proposal to unilaterally assign SoCalGas capacity to PG&E and SPURR's proposal to allocate a *pro rata* share of El Paso Natural Gas Company (El Paso) capacity to core aggregation customers (to which PG&E concurs) with the core aggregation customers being able to pick and choose on a monthly basis, as opposed to a yearly basis, whether they want to use and pay for the capacity (to which PG&E objects).

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Finally, PG&E and ORA collaborated on revisions to the sequencing methodology to reflect the full integration of the Transwestern Pipeline Company (Transwestern) and El Paso capacities, in accordance with the last bullet point at the bottom of page 1 of Ex. 1, and have reached agreement on the appropriate sequencing methodology. The agreed-upon methodology is included in this brief.

There is no controversy with regard to the major issues identified for this phase of the proceeding insofar as PG&E is involved:

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. PG&E's holding of Transwestern capacity for the benefit of core customers is reasonable;
3. 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 rates in a manner analogous to the recovery of PG&E's other interstate capacities held for the core;
4. The adjustments to PG&E's Core Procurement Incentive Mechanism (CPIM) listed in Ex. 1 should be made to accommodate the new El Paso capacity and the changed status of the Transwestern capacity;
5. Recovery of PG&E's El Paso costs from its core procurement customers should be made 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. Full recovery of PG&E's Transwestern costs from its core ratepayers should become effective as of July 1, 2003, in accordance with Ex. TW-102. The reallocation of costs between customers for El Paso costs and the full

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recovery of Transwestern costs will be made in a compliance advice filing following the effective date of a decision in Phase II;

6. Short-term releases of both the El Paso and Transwestern capacity should be 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;

7. 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.

I. THE COMMISSION SHOULD NOT REALLOCATE ANY EL PASO CAPACITY HELD BY SOCALGAS TO PG&E.

SCGC continues to advocate unilaterally assigning some SoCalGas El Paso capacity to PG&E.[1] PG&E has repeatedly reminded everyone in this proceeding that it has signed up for an adequate amount of capacity at this time and does not need or want more. PG&E acquired more El Paso capacity (203.5 MDth/d) as a result of this proceeding than all of the other utilities combined (SoCalGas 142 MDth/d; SDG&E 12.5 MDth/d; Edison 9 MDth/d; and Southwest Gas 7 MDth/d (Ex. 3 (SoCalGas), page 2)). It would be particularly incongruous to foist more SoCalGas capacity on PG&E after PG&E had already acquired the lion's share of the statewide capacity acquisitions.

SCGC's recommendation includes pre-existing capacity held by SoCalGas beyond the amount of new capacity acquired by SoCalGas. In response to Decision 02-

[1] SCGC's Northern California counterpart, the Northern California Generation Coalition, has been silent in this proceeding, other than a letter supporting PG&E's original testimony, Ex. 30.

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07-037, SoCalGas acquired 103 MMcf/d of El Paso capacity to Topock. Ex. 3, p. 7. Yet SCGC is recommending that 157 MMcf/d of SoCalGas' Topock capacity be assigned to PG&E. SCGC brief, p. 10. SCGC is clearly simply trying to enable its members to escape responsibility for paying for SoCalGas capacity, regardless of whether it was acquired pursuant to Decision 02-07-037, or was pre-existing capacity. Forced assignment of capacity from one utility to another was not one of the potential issues identified for Phase 2 of this proceeding in the December 26, 2002, Scoping Memo. In another proceeding, which denied consolidation of the gas portfolios of SoCalGas and SDG&E, the Commission indicated that it would consider voluntary assignments of capacity as part of this proceeding:

> "In this decision, we will not assign to SDG&E or any other customer (including SoCalGas' own core procurement department) the interstate capacity that reverts back to SoCalGas between November 1, 2001 and August 31, 2006. We believe it is prudent, however, to consider directing SoCalGas to first make available, consistent with the Federal Energy Regulatory Commission's capacity rules, this capacity to its wholesale customers and other gas utilities that procure gas for core customers.[2] This flexibility would allow shippers to select the capacity delivery points and terms that best fit their respective needs. In a separate Rulemaking R.02-06-041, we require California energy utilities to acquire capacity that becomes available on the El Paso Pipeline. We will consider the reverting SoCalGas capacity identified in this decision, in the appropriate phase of that proceeding." Decision 02-08-065, mimeo p. 17.

While it is clear that voluntary assignments of SoCalGas capacity can be considered in this proceeding, forced assignment of pre-existing capacity from one utility to another is beyond the scope of this proceeding. SCGC, in its brief at page 34, makes a similar procedural argument that a TURN recommendation to use the SoCalGas capacity to establish a natural gas storage reserve, should not be considered because it is beyond the scope of this proceeding.

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[2] Including PG&E, which is not a wholesale customer of SoCalGas but which does procure natural gas on behalf of its own core customers.

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SDG&E rejects the forced assignment of SoCalGas capacity on it for essentially the same reasons that PG&E rejects it:

> "Since SDG&E began procuring gas in 1986, it has been able to take advantage of the fact that it was not allocated all of its core requirements with firm capacity from the southwest because the brokered costs gave SDG&E a distinct price advantage. Such a forced assignment now would preclude SDG&E from considering the full range of options to serve its core customers, potentially limiting economic and reliability benefits from a diversified supply and capacity portfolio. The Commission has already secured price insurance for the border basin price differential for the State of California through its El Paso turned back capacity order. The issue now is cost allocation." – SoCalGas/SDG&E brief, p. 6.

SoCalGas and SDG&E do argue that voluntary assignments of the capacity could and should be acceptable. SoCalGas/SDG&E brief, p. 7.

SCGC continues to assert that SoCalGas has too much capacity. SCGC brief, p. 6. PG&E's opening brief questioned that assertion. PG&E brief, p. 15. SCGC's "fact" that SoCalGas has 406 MMcf/d of excess capacity is further belied by the fact that, in addition to the capacity acquired by SoCalGas pursuant to Decision 02-07-037, SoCalGas had acquired, on its own, other southwest interstate capacity since its last BCAP proceeding:

> Q Do you know of the 18 additional that SoCalGas purchased after the initial reservation of 1044 was adopted was also Southwest supplies?
> A Yes.
> Q Can you tell me why SoCalGas didn't utilize capacity that it currently brokers as part of this 406 and instead purchased an additional 18 for the core?
> A No.
> - Transcript, p. 156 (SoCalGas, Watson)

Perhaps SoCalGas needed more capacity because its "excess" capacity is not very valuable. Even SoCalGas' affiliate, SDG&E, argues against an assignment of that capacity because a substantial portion of that capacity is economically worthless:

> "The Phase II Direct Testimony of SoCalGas (at page 7) indicates that an estimated $8.8 million of stranded cost per year results from El Paso capacity from the Permian basin which, in the current market, is "almost worthless" relative to access to the lower-cost San Juan basin. This was particularly true during this last winter, when Permian prices frequently rose much higher than California border prices. During that period, it was often economic for SDG&E to leave its own El Paso capacity idle from the Permian and buy its gas at the border in order to lower gas costs for its customers. With an incremental assignment of turned back capacity from that high-cost basin, the additional costs coming to SDG&E will be borne entirely by its core customers for little if any value in the expected case. These costs would be allocated to a much smaller customer base than from using an ECPT treatment of the stranded costs across SoCalGas' entire customer base, leading to higher gas costs for SDG&E's core.
>
> SCGC also sponsors an assignment by SoCalGas of El Paso turned back capacity to SDG&E that could result in a transfer of the pipeline costs to its core customers. Although SCGC proposes assignment of capacity with receipt points in the San Juan basin, the ability to designate specific receipt and delivery points for the SoCalGas turned back capacity packages available for assignment is not yet certain. SDG&E could be then required to take a pro-rate share of all such receipt and delivery points. This will result in some capacity not being used fully and these stranded costs adding to the SDG&E core customer cost burden." – Ex. 4 (SDG&E), pp. 4-5. See also SoCalGas/SDG&E brief, pp. 6-7.

PG&E has been quite clear throughout this proceeding that the approximately 204 MDth/d of new capacity that PG&E acquired as a result of this proceeding was an appropriate amount to assure safe, reliable service at reasonable cost.[3] The 204 MDth/d was the amount agreed-upon in the Ex. 1 Stipulation and Agreement between PG&E and ORA which concluded that amount was to be held for the benefit of core customers and should be fully recoverable in core rates. PG&E does not want to be forced to take additional capacity at this time, and additional capacity is not needed to provide least-cost service to core customers. The fact is that holding capacity is good insurance against high demands and price spikes, and that is the basis for SCGC's argument. But holding capacity costs money, and one always needs to use judgment in weighing the

[3] See, e.g., PG&E's July 12, 2002 Reply Comments to the OIR, at p. 8; Ex. 31, pp. 1-6

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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. Moreover, the benefits of holding capacity described by SCGC apply equally well to noncore shippers. By allocating the costs of PG&E's 204 MDth/d of El Paso capacity to PG&E's core customers, those customers have already stepped up to the plate and assumed a significant responsibility in the pursuit of the Commission's overall objective of securing El Paso capacity for the state of California.

If the Commission does decide to unilaterally allocate additional SoCalGas capacity to PG&E (which the Commission should not do), then the costs associated with that additional capacity should be entirely allocated to noncore customers until such time that it can be shown that the core can and will use the additional capacity. PG&E has discussed this addition to its cost allocation proposals with the two parties with which it has reached the specific agreements embodied in Exs. 1 and TW-102, and both TURN and ORA support this addition to the cost allocation proposal.

In summary, the Commission should not force additional SoCalGas capacity on PG&E at this time. If it does, and only if it does, the cost of that additional capacity should be borne by PG&E's noncore customers until such time that it can be shown that the core can and will use the additional capacity.

II. CORE AGGREGATORS SHOULD NOT BE ALLOWED TO GET A BETTER DEAL THAN OTHER CORE CUSTOMERS, AND SPURR'S "IMMEDIATE REFUND" PROPOSAL SHOULD BE REJECTED.

SPURR presented no testimony in this proceeding, but through cross-examination and its opening brief, SPURR made two proposals: (1) a *pro rata* share of the new El Paso capacity should be made available to core aggregation customers and those customers, unlike other core procurement customers, should be allowed to choose whether they want to take and pay for that capacity on a monthly, as opposed to a yearly basis; and (2) that core aggregation customers should receive immediate refunds of their

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equal-cents-per-therm contributions upon Commission ratification of the Ex. 1 agreement that the El Paso capacity should be charged to core ratepayers. There is no reason why core aggregation customers should get different, better treatment than other core customers.

A. Core Aggregation Customers Should Be Offered an Opportunity to Sign Up For a *Pro Rata* Share of the El Paso Capacity, But On the Same Basis As Other Core Customers, As Determined in the Gas Accord Proceeding.

This issue first came up in SPURR's counsel's cross-examination of PG&E witnesses. In a nutshell, the new El Paso capacity will be held for the benefit of core customers. Core aggregation customers want the opportunity to be able to sign up for a *pro rata* share of the new capacity, if they believe it is in their best interest to do so. PG&E has no problem with that principle. However, SPURR also wants core aggregation customers to have the option to acquire capacity on a monthly basis, rather than on a yearly basis. That would be fundamentally unfair to the other core customers – those served by the utility procurement portfolio - and should be rejected.

The market value of pipeline capacity varies from month to month and year to year depending on weather and other market fundamentals. When the utility core procurement portfolio becomes fully responsible for the new El Paso capacity, it will have to pay for it on an annual basis. What SPURR wants to do is to enable core aggregators to take a share of the El Paso capacity during months when the capacity is more valuable, and stick the costs of the capacity on the other core customers when the capacity is less valuable. The proposal is unfair on its face, and should be rejected. The issue was fairly illuminated in the transcript at pages 274-283 (PG&E, McLafferty) and 306-318 (PG&E, Clavier).

The basis for SPURR's proposal is that core aggregators received such an arrangement for other defined PG&E capacity in the first Gas Accord. That arrangement was the result of negotiations and trade-offs among various parties and issues and the

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desire of all parties to reach a global settlement in that proceeding. The continuation of that arrangement is clearly an issue in the second Gas Accord proceeding (A. 01-10-011) which is being litigated and is pending before the Commission. The issue should be decided in that proceeding. If a stand-alone decision on the issue is to be made in this proceeding, SPURR's proposal should be denied as unfair to PG&E's bundled core customers who would have to pay more for capacity when it is less valuable and get less capacity when it is more valuable.

B. Core Aggregation Customers Should Receive Their Fair Share of any Refunds (or Bill Credits) At the Same Time and Same Manner as Other Customers of PG&E.

All parties in this proceeding agree that core procurement customers should be allocated all of the costs of PG&E's 203 MDth/d of El Paso capacity (except for any capacity taken on by core aggregators) and that these costs should be removed from core and noncore transportation rates. PG&E proposed in its testimony, not contested by any party: "to remove El Paso pipeline capacity costs from transportation rates and return all revenues collected through these rates back to core and noncore customers, respectively." (Ex. 30 at 4-3); and "[t]he remaining El Paso balancing account balance . . . will be returned to core and noncore customers through a credit to the El Paso capacity charge in transportation rates." (Ex 30 at 3-6) Consistent with its uncontested testimony, PG&E's Opening Brief states: "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." (PG&E Opening Brief at p. 11)

Calpine et al., for example, agrees with this position in its opening brief: "If the Commission adopts PG&E's proposal, which it should do, there will be a need for retroactive adjustments to those charges that have already been assessed. No party objected to this proposal and it should be part of the Commission's decision." (Calpine et

al. Opening Brief at p. 36) Calpine et al.'s understanding is consistent with PG&E's proposal to adjust transportation rates to return the money collected from customers.

SPURR, on the other hand, for the first time in its opening brief recommends that "refunds should be provided to core aggregation customers immediately upon the effective date of this Phase II decision." (SPURR Opening Brief at p. 7) There is no record basis for SPURR's proposal. A refund is more costly to administer than a decrease to transportation rates. If a refund was made only to core aggregation customers, it would result in different transportation rates for bundled and core aggregation customers, making the comparison between portfolio offerings more difficult, and create a potential for double recovery of the overpaid amount for any core aggregation customers that choose to migrate to core bundled service during the relevant time periods. There is no reason to treat core aggregation customers differently and better than other core customers. They should get whatever overpayment is due them, but in the same time and manner as other customers. No additional expense should be incurred to provide a different and more complex return mechanism.

The decision in this proceeding should include a requirement that orders PG&E to file an Advice Letter (AL) 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. The AL should also contain a prospective effective date.[4] Providing some flexibility is desirable because, depending on the timing of the decision in this proceeding, it may make sense to consolidate these transportation rate changes with transportation rate changes that may result from other gas-related rate change proceedings, such as the Annual True-up of Transportation Balancing Accounts advice

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[4] This is similar to Ordering Paragraph 7 in Resolution G-3339 which ordered PG&E to "file an Advice letter within 20 days of the effective date of this resolution proposing filing procedures and methods as well as identify tariff adjustments necessary to implement this core/noncore allocation of the El Paso pipeline costs and reallocation referenced in OPs 1, 2, 4, and 6. The AL is to also contain a prospective effective date. The advice letter is subject to Energy Division review and approval."

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filing made at the end of non-Biennial Cost Allocation Proceeding years. In any event, the Commission should not order a direct refund to any class of customers in this decision, as this will be unnecessarily costly and result in unequal treatment of customers.

III. THE COMMISSION SHOULD RATIFY THE SEQUENCING MODIFICATIONS TO PG&E CORE PROCUREMENT INCENTIVE MECHANISM AGREED UPON BY PG&E AND ORA.

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.

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

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new El Paso capacity and the changed status of the pre-existing 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/ORA 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.
8. Core aggregation customers should not be given better treatment than other customers.

Respectfully submitted,

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ATTACHMENT

CPIM Sequencing Modifications

The following modifications to the CPIM benchmark sequencing methodology are appended to the ORA/PG&E Settlement listed as Exhibit 1.

- Inclusion of Transwestern and El Paso Capacity: The 150 MDth/d of Transwestern and the 204 MDth/d of El Paso capacity shall be treated like other transmission capacity held for core customers under the current CPIM: The annual benchmark will include a dollar amount equal to the annual Transwestern and El Paso demand charges. Revenue from brokering unused capacity will be credited against actual costs.

- Sequencing Adjustments: The load sequencing methodology developed in the original Gas Accord CPIM identified five supply source "paths": Silverado, Kingsgate (mismatch), AECO C, Topock and Topock plus Baja as-available. The volume associated with each of first four paths was determined by the amount of gas that could be delivered from the identified supply source to the PG&E Citygate using firm transportation held for the core. The Baja as-available path applies when the daily load exceeds the available firm transport plus pre-determined storage withdrawals. For purposes of constructing the daily benchmark, these additional volumes were assumed to be purchased at Topock and shipped to the PG&E Citygate using Baja as-available capacity. The order of the sequence was as follows: Silverado, Kingsgate, AECO or Topock depending on which was the lower cost basin as determined by the first-of-the-month indices, Baja as-available. The revised CPIM will include two new sequencing paths in addition to the original five paths described above. The two new paths reflect the cores direct access to the San Juan and Permian supply basins._The San Juan path combines the Transwestern, El Paso and matching firm Baja capacity held for the core over which gas can be transported from the San Juan basin to the PG&E Citygate on a firm basis. The Permian path combines the core's El Paso Permian capacity with available firm Baja capacity. The sequencing order under the revised CPIM is as follows: Silverado, Kingsgate, AECO C or San Juan or Permian, depending on least costs as determined by the first-of-the-month published indices, Topock, Topock plus as-available. The benchmark indices associated with the new paths are the monthly Inside FERC San Juan index adjusted on a net-forward basis to the PG&E Citygate using Transwestern volumetric rates and the monthly Inside FERC Permian index adjusted on a net-forward basis to PG&E Citygate using.

- 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

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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.

- Kingsgate index: The current CPIM uses a Kingsgate index to determine the price of gas purchases at Kingsgate. However, the market at Kingsgate has become very illiquid, and the current market indices at Kingsgate are not sufficiently robust or have cease to exist completely due to lack of market activity. In lieu of a Kingsgate index, ORA and PG&E have agreed to instead use the AECO C monthly index plus the TransCanada as-available transport rate.

- Exchange Rates: For the purpose of setting the sequence, the currency exchange rates in effect at the time the indices are issued will be used. The exchange rate used in determining the monthly sequence will be the exchange rate published by the Canadian Gas Price Reporter on the day the monthly AECO C price is published. Exchange rates used to for bill payment and to calculate gas costs will remain unchanged.

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