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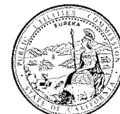

January 28, 2004

TO: ALL PARTIES OF RECORD IN RULEMAKING 02-06-041

Decision 04-01-047 is being mailed without the Concurrence of Commissioner Lynch. The Concurrence will be mailed separately.

Very truly yours,

/s/ ANGELA K. MINKIN by KKH
Angela K. Minkin, Chief
Administrative Law Judge

ANG:sid

Attachment

Mailed 1/28/2004

Decision 04-01-047 January 22, 2004

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)

OPINION ESTABLISHING COST ALLOCATION FOR EL PASO TURNED BACK CAPACITY

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OPINION ESTABLISHING COST ALLOCATION FOR EL PASO TURNED BACK CAPACITY

I. Summary

This opinion establishes cost allocation methodologies for Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SoCalGas), Southern California Edison Company (Edison), Southwest Gas Corporation (Southwest Gas), and San Diego Gas & Electric Company (SDG&E) for the costs of the turned back capacity on El Paso Natural Gas Company's (El Paso) interstate pipeline that the utilities were ordered to procure pursuant to Decision (D.) 02-07-037.

II. Background

On May 31, 2002, the Federal Energy Regulatory Commission (FERC) issued an order indicating that marketers currently serving California may turn back up to 725 MMcf/d of firm capacity on the El Paso pipeline to El Paso's east of California (EOC) customers.[1] This Commission was concerned that unless California replacement shippers or California utilities acquired the turned back capacity, it could be permanently lost to California. Because the FERC order required the EOC marketers to decide by July 31, 2002, how much capacity they would be turning back, the Commission expedited its rulemaking process and issued D.02-07-037 on July 27, 2002, requiring the natural gas and largest electric utilities to acquire the turned back capacity. The Commission feared that if this capacity was lost to customers outside of California, the loss "could have devastating impacts on both the supply and cost of gas and electricity for California customers." (D.02-07-037, p. 3.)

To resolve this concern, D.02-07-037 established two rules: (1) ordering the gas and electric utilities to each sign up for a proportionate amount of the

[1] El Paso Natural Gas Company, et al., 99 FERC Section 61,244 (2002).

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turned back capacity not subscribed to by replacement shippers serving California, and (2) finding just and reasonable and pre-approving the utilities' subscription to this turned back capacity. Issues concerning the cost allocation for this newly acquired capacity were deferred to Phase II of the proceeding.

A prehearing conference (PHC) was held on September 10, 2002, for Phase II, and then a scoping memo issued detailing the issues for Phase II. The parties filed testimony and rebuttal in April 2003, and evidentiary hearings were held April 28 through May 2, 2003. Opening briefs were filed July 7, 2003, by SoCalGas and SDG&E, Southwest, Edison, PG&E, the Office of Ratepayer Advocates (ORA), Southern California Generation Coalition (SCGC),[2] The Utility Reform Network (TURN), the California Manufacturers & Technology Association (CMTA), Coral Energy Resources, L.P. (Coral), and Calpine, Duke Energy North America, Mirant Americas, Inc., and Watson Cogeneration Company (Electric Generators or EGs), and reply briefs were received July 28, 2003, from the Electric Generators, ORA, PG&E, Edison, SoCalGas and SDG&E, SCGC, and TURN.

A Proposed Decision (PD) of the assigned Administrative Law Judge (ALJ) issued November 4, 2003. Comments were received from CMTA, the Electric Generators, SoCalGas and SDG&E, SPURR/ABAG POWER, ORA, PG&E, Edison, SCGC, and TURN. Reply comments were received from SoCalGas and SDG&E, ORA, PG&E, and the Electric Generators.

III. Phase II

Pursuant to D.02-07-037, the scoping memo for Phase II specified that if the gas and electric utilities fully complied with the decision in terms of acquiring the amounts or percentages of El Paso capacity at the delivery points indicated,

[2] On July 11, 2003, SCGC filed an Errata Notice clarifying that the recommendations presented in the opening brief SCGC filed on July 7, 2003, were also supported by Cabrillo I, LLC, Cabrillo II, LLC, El Segundo Power, LLC, and Long Beach Generation, LLC.

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then the utilities would recover their costs for the capacity. All parties agree that the utilities complied with the acquisition order in terms of the amount of capacity.[3]

The scoping memo for Phase II also identified the following issues for resolution:

- 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;
- Any appropriate adjustments to a utility's gas cost incentive mechanism to properly account for both existing and recently-acquired interstate capacity;
- 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 D.02-07-037;
- Whether and how short-term capacity releases of interstate capacity (in excess of the utilities' need) should be allowed; and
- The criteria under which the Commission should authorize adjustments to interstate capacity holdings or long-term capacity releases.

IV. Procurement of Additional Capacity

While there is consensus among the parties that all the utilities complied with D.02-07-037 by acquiring specified amounts and delivery points of turned-back El Paso capacity, the parties now want clarification from the

[3] See Attachment "A" that sets forth the amounts of El Paso turned back capacity acquired by each utility.

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Commission whether the utilities have a continuing obligation to secure additional El Paso Capacity. In particular, CMTA, SoCalGas and SDG&E, Southwest, and the Electric Generators advocated that the Commission find no continuing obligation for acquisition of additional El Paso capacity.

The Commission finds that the rule established in D.02-07-037 presumed that California needed to preserve as much capacity as possible on the El Paso line, and it would be contrary to the original rule to not direct the utilities to continue to secure capacity for the short term. The record in this proceeding does not indicate what the long term needs for gas capacity will be for California post-2005. In order to plan for post-2005, the Commission intends to hold workshops on long-term gas capacity needs, then open an Order Instituting Rulemaking (OIR) or an Order Instituting Investigation (OII) on the utilities' long-term procurement needs. The Commission anticipates that an order in that proceeding will supersede D.02-07-037. Until that decision is issued, the gas utilities and Edison are directed to renew any short-term contracts on the El Paso pipeline that expire before 2005, for a term that covers through the end of 2005.

If the renewal of any of the El Paso contracts would require that the contract extend beyond December 31, 2005, the utility is not obligated to renew that contract, but may replace the expiring contract capacity amount from other sources.

V. Allocation of Costs

The Commission was clear in D.02-07-037 that "each utility's costs associated with acquiring turned back capacity will be recovered in its own customer rates . . . " The parties did not challenge this, nor did they suggest a different framework. Where the parties differ is on how the cost recovery should be allocated between core and non-core customers for each utility. And even on this contested point, there is unanimity among the parties on cost allocation for

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Edison, Southwest, SDG&E, and PG&E. The focus of the dispute is on allocation of costs for SoCalGas.

ORA proposed, and all the utilities accepted and agreed with the following and made the same proposals in their testimony:

- SoCalGas should recover the costs of its turned back capacity from all its customers, both core and noncore, on an Equal Cent Per Therm (ECPT) basis;

- Edison should recover the costs of its turned back capacity from all of its customers; and

- Southwest, SDG&E, and PG&E should recover the costs of the turned back capacity from their core customers.

The intervenors oppose this approach; however, and most of their competing proposals concerned SoCalGas.

A. Edison

Edison acquired capacity on the El Paso line beginning November, 2002, as required by D.02-07-037, and each month since Edison has released all of its turned back capacity and the fees and credits associated with the capacity have been recorded in Edison's Turned Back Capacity Account. Once a final decision issues in this phase of the proceeding, Edison will transfer the balance to the Energy Resource Recovery Account (ERRA). Going forward, Edison should allocate the credits and fees associated with its El Paso turned back capacity among its electric customers through the ERRA. No party objected to this proposed cost allocation, and the Commission finds it reasonable.

B. Southwest Gas

Southwest Gas complied with the Commission's directive to acquire turned back capacity on the El Paso line and proposes using that capacity for core needs. Southwest's core customers represent 99% of its customer base, the turned back capacity will be used for the benefit of the core customers, so Southwest proposes recovering costs for El Paso capacity in the same manner it recovers other capacity costs which is pursuant to its Core Fixed Cost Adjustment Mechanism of its California Gas Tariff. No parties protested this suggestion and the Commission finds it reasonable and adopts this cost recovery mechanism for Southwest Gas.

One issue of controversy associated with this gas utility is the EGs' and CMTA's proposal that SoCalGas reallocate 2 MMcf/d of its excess turned back capacity to Southwest Gas for its core customers. Southwest Gas did not respond to this suggestion, nor did any of the responding parties. In the PD, we found that this proposal had merit and directed Southwest Gas to acquire 2 MMcf/d of SoCalGas' excess El Paso capacity to insure that it could meet 70% of its cold-year demand from interstate capacity. Following a review of the comments we no longer require Southwest Gas to fill this need from the

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SoCalGas excess capacity. We do not want to limit the economic and reliability benefits of a diversified supply and capacity portfolio for Southwest Gas, nor do we want to preclude the utility from taking advantage of other attractive capacity options.

Southwest Gas, as a wholesale gas customer of SoCalGas, asks to be exempt from allocation of any SoCalGas' turned back capacity costs because Southwest Gas' customers are already paying for the capacity Southwest Gas acquired. SDG&E is also a wholesale gas customer of SoCalGas and Edison is an electric generation customer of SoCalGas, and they were also ordered to acquire turned back El Paso capacity. Edison and SDG&E have to charge their customers for their El Paso capacity as well as pay for their allocation of SoCalGas' El Paso capacity.

We find the exemption requested by Southwest Gas is not supportable because we are ordering that all stranded costs for SoCalGas be allocated to all customer classes on an ECPT basis. That order applies to wholesale gas customers as well. However, if Southwest Gas takes a direct assignment from SoCalGas, Southwest will receive a credit against its ECPT allocation for the gas it takes. This is not an exemption for Southwest Gas, but as discussed further in this decision, is applicable to any wholesale customer taking a direct assignment from SoCalGas.

C. SDG&E

SDG&E proposes allocating all of its newly acquired turned back El Paso capacity, as well as the cost of this capacity, to its core procurement department. No party objects to this proposal and the Commission finds it reasonable and adopts this cost recovery mechanism for SDG&E.

The only controversial recommendation concerning SDG&E, presented by CMTA, SCGC, and the Electric Generators, was that SoCalGas reassign 32 MMcf/d to 42 MMcf/d of its excess capacity to SDG&E. SoCalGas, SDG&E,

and ORA oppose any forced reassignment of excess capacity from SoCalGas to SDG&E. SDG&E is concerned that a forced assignment would preclude SDG&E from exploring the full range of options it has used to serve its core customers. SDG&E has not met all of its core requirements with firm capacity from the southwest because the utility found that the range of options available from a diversified supply and capacity portfolio gave it a distinct price advantage.

However, SDG&E would not necessarily object to assignments from SoCalGas of capacity with San Juan receipt points, if the specific receipt and delivery points were certain.

SDG&E might be willing to voluntarily accept an assignment of a proportional amount of turned back capacity from SoCalGas with the same receipt and delivery point distribution as their entire award if SDG&E also receives an off-setting credit against its ECPT allocation for that amount. This approach would be consistent with D.02-08-065 where the Commission denied the application of SoCalGas and SDG&E to consolidate their gas acquisition management and gas supply portfolios, but did leave open the possibility of establishing brokering or allocation of unassigned SoCalGas El Paso capacity. SDG&E proposes that the percentage of SoCalGas' stranded costs determined on an ECPT basis for SDG&E's utility-procurement core customers would be applied to SoCalGas's total turned back capacity. SDG&E would then manage that capacity to reduce its own supply delivery costs, and the associated SDG&E core ECPT cost/benefit would be transferred from SoCalGas to SDG&E so that SDG&E has no ECTP obligation to SoCalGas for El Paso turned back capacity.

In the PD, we found it reasonable to direct SDG&E to take an assignment of 31 MMcf/d of turned back El Paso capacity from SoCalGas so SDG&E could meet 70% of its cold-year core demand from interstate capacity. After reviewing the comments submitted by SoCalGas and SDG&E we will no longer require this forced assignment. SDG&E is free to fill its capacity needs by

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a voluntary assignment from SoCalGas, with the corresponding off-setting credit against SDG&E's ECPT allocation, or the utility may take advantage of other capacity options. As SDG&E urged in its comments, the forced assignment could limit the economic and reliability benefits of a diversified supply and capacity portfolio and could preclude the utility from taking advantage of more attractive capacity options. We find that argument has merit and no longer direct SDG&E and Southwest Gas to take forced assignments from SoCalGas.

D. PG&E

PG&E proposes to use its acquired turned back El Paso capacity to serve its core market, and correspondingly to allocate the costs of that capacity to the core customers. The turned back capacity will provide PG&E's core customers with additional reliability and insurance against border price spikes as it allows PG&E access to such producing regions as the San Juan and Permian Basins, providing competitive alternatives to Canadian sources.

All of the parties, except for ORA and TURN, agreed with PG&E's recommendation. During the course of the proceeding PG&E entered into stipulations with ORA and TURN that reasonably resolved the allocation of cost issue: PG&E's El Paso capacity is fully recoverable in core rates in a manner analogous to the recovery of PG&E's other interstate capacities held for the core. TURN supports this cost allocation methodology, unless we adopt an ECPT for SoCalGas. TURN argues that if the Commission adopts ECPT for one utility it should adopt that same principle for allocation of the costs of the turned back capacity acquired by all of the utilities. In fact, TURN states that if ECPT is adopted for SoCalGas, TURN will no longer support an allocation of costs to PG&E's core customers.

We find that it is reasonable and comports with D.02-07-037 to allocate PG&E's costs of its El Paso turned back capacity to its core customers since it will be used to serve that market.

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The only other issue that is not fully resolved concerning PG&E in Phase II of this proceeding is the suggestion by SCGC that some of SoCalGas' excess El Paso capacity be reallocated to PG&E. According to SCGC, PG&E needs additional capacity to meet its core requirements for an average year cold month standard, and SoCalGas currently has PG&E-Topock capacity available for reassignment to PG&E. SCGC argues that by reassigning this capacity to PG&E, PG&E's core customers would obtain protection against border and Citygate price spikes and they would have diversification from dependence on Canadian supplies.

As an alternative, SCGC proposes that this capacity could be reassigned to PG&E as PG&E's prearranged contracts for recently acquired El Paso capacity expire on October 31, 2003, and December 31, 2004.

While SoCalGas is open to SCGC's main proposal, PG&E is not. Not surprisingly, PG&E argues that unilateral reallocation of SoCalGas' capacity to other utilities, including itself, by the Commission is not supportable. SCGC's proposal is founded on two assumptions: SoCalGas has excess capacity and PG&E's core has too little. PG&E suggests that the first assumption is uncertain, and the second is untrue. PG&E contends that after its acquisition of the El Paso capacity, it now has the right amount of capacity—70% of its cold-year core demand. Although holding additional capacity may be good insurance against high demands and price spikes, PG&E is concerned about the capacity holding costs and the value of the additional capacity against the cost.

Although PG&E is against the unilateral allocation now, it is receptive to assuming some of SoCalGas' capacity, when PG&E's El Paso contracts expire. PG&E would consider the SoCalGas capacity if it could assume an amount equivalent to the expired contracts, and if the acquired capacity is as desirable as PG&E's current capacity in respect to the specifics of the producing basins, the price, and the terms of the contracts.

ORA opposes the allocation of SoCalGas capacity to PG&E on the grounds that it is outside the scope of this proceeding, makes PG&E customers pay for turned back capacity acquired by SoCalGas, and narrows the customer base over which the cost is spread. In D.02-07-037, the Commission stated that the costs of the turned back capacity from El Paso would be borne by customers of the utility that acquired it. ORA argues that reallocation and swapping should be addressed as capacity planning, rather than cost allocation, and therefore should be considered in the Biennial Cost Allocation (BCAP) proceeding or any other appropriate proceeding. ORA interpreted SCGC's proposal as an attempt by noncore customers to shift unused capacity and the related stranded costs out of consideration for payment by noncore customers.

TURN, in its reply brief, indicated that it might find SCGC's "substitution" proposal acceptable, if the Commission countenances a net decrease in holdings of El Paso capacity. TURN supports such a substitution of capacity when PG&E's contracts expire, as long as there is no harm to PG&E's core customers and there is a resulting benefit to the core and noncore of SoCalGas. TURN would like the costs of the remaining turned back capacity allocated to SoCalGas' ITCS account, and only wants pre-existing capacity with San Juan access shifted to SoCalGas' core customers.

SCGC's proposal of substituting SoCalGas excess capacity for PG&E's expiring contracts has the net result of reducing the total amount of excess capacity available in California. D.02-07-037 directed the utilities to secure additional capacity because we found that there was a benefit, at least through 2005, in having that capacity cushion. It would be contrary to the original rule to allow PG&E to substitute SoCalGas capacity for its expiring contracts. We find that it is reasonable for PG&E to renew any short term contracts that expire before 2005, for a term that secures the capacity through the end of 2005.

SPURR/ABAG POWER, core aggregation customers of PG&E, want:

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(1) a refund to core aggregation for El Paso costs that were borne by them during the period PG&E reserved and used the capacity exclusively for its core procurement customers; and (2) an order to PG&E that the utility should make a proportional share of the El Paso and Transwestern capacity allocated to the core market available to the core aggregation customers in accordance with the current terms of the PG&E Gas Accord.

PG&E concurs with SPURR/ABAG POWER's recommendations, but takes issue with their proposal to allocate a pro rata share of the El Paso capacity to core aggregation customers and those customers, unlike other core procurement 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. PG&E's position is that SPURR/ABAG POWER, as a core aggregation customer, should not get treatment different than other core customers.

In the PD, we found that the requested refund to core aggregation customers was not supportable. After reviewing the comments, we determine that was an oversight and find that the core aggregation customers are entitled to a refund, along the same terms and conditions as the other noncore customers of PG&E. In addition, we agree that El Paso and Transwestern capacity should be made available to core aggregation customers of PG&E in accordance with A.01-10-011.

E. SoCalGas

SoCalGas is in a unique position vis-à-vis the other gas and electric utilities with the acquired El Paso turned back capacity in that SoCalGas already had 406 MMcf/d of excess capacity on the El Paso system. Pursuant to the Commission's directive in D.02-07-037, SoCalGas acquired an additional 139 MMcf/d of turned back capacity. Therefore, SoCalGas has significant stranded costs associated with its capacity holdings on the El Paso system, and

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the parties differ in their recommendations as to how these stranded costs should be allocated.

SoCalGas believes that the stranded costs associated with the turned back El Paso capacity should be allocated to all customers on a volumetric ECPT basis. SoCalGas recommends this approach because the excess capacity neither benefits, nor burdens, any one customer class more than others. D.02-07-037 found that both core and noncore customers benefit from the turned back capacity, and that "spreading the costs of turned back capacity over as many ratepayers as possible minimizes the impact of turned back capacity on any particular utility's customers." (*Id.*, pp. 25-26, Findings of Facts 14 and 16.)

We find it reasonable for SoCalGas to recover the costs of its El Paso turned back capacity from all of its customers on an ECPT basis, and discuss the details of this approach below.

1. Direct Assignment

To reduce the stranded costs, SoCalGas proposes allowing its wholesale customers, including Southwest Gas and SDG&E, to take upfront one-time direct assignments of the turned back El Paso capacity, paying proportionate shares of receipt and delivery points for the full term at the full as-billed rate, to the extent that they take, or we order, a direct assignment. Customers taking a direct assignment would step into the shoes of SoCalGas, and would receive a credit against their respective ECPT allocation for every dollar of assigned capacity. This direct assignment concept presupposes that the capacity stays in California.

SCGC supports this direct assignment proposal, and in fact opines that this mechanism for dealing with turned back capacity should be applied to SoCalGas' existing excess capacity of 406 MMcf/d so that customers could get a credit against the ITCS.

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The Electric Generators, along with ORA, and SDG&E also advocate the adoption of SoCalGas' direct assignment and credit mechanism. Coral Energy, however, strongly opposes this credit mechanism because under the terms presented by SoCalGas, the credit would only be available to end-use customers located within SoCalGas' service territory. This mechanism would not allow a credit to a customer located on another utility's system, to a contracted marketer, or to a marketer/supplier even if the capacity were used to serve an end-use customer on SoCalGas' system. In sum, Coral Energy argues against this mechanism because Coral feels it would violate the FERC's capacity release provisions since it would provide an undue preference to one class of shippers.

In reply briefs, parties argued that Coral's arguments were misguided. SoCalGas posits that a holder of firm capacity rights on an interstate pipeline may enter into a "prearranged deal" to release its capacity rights to a replacement shipper as long as the deal is posted on the pipeline's electronic bulletin board. SoCalGas proposes doing just that. Other parties suggested that since marketers do not pay for stranded costs in the first place, marketers and noncore customers are not similarly situated and as such, it is not unduly discriminatory to provide a credit to customers that take an assignment of the capacity but not to marketers.

We are not convinced by Coral's arguments and find reasonable SoCalGas' direct assignment proposal, whereby its customers may take upfront one-time direct assignments of the turned back capacity, paying proportionate shares of receipt and delivery points for the full term at the full as-billed rate, to the extent that they take, or we order, a direct assignment. Customers taking the assignments would receive a credit against their respective ECPT allocation for every dollar of assigned capacity as long as the capacity stays in California. If the capacity leaves California, the credit no longer applies.

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2. Increasing SoCalGas' Core Holdings

The Electric Generators and CMTA suggest that in addition to allocating some of its excess turned back capacity to SDG&E and Southwest Gas, SoCalGas should increase its own core interstate capacity holdings by 60 MMcf/d. They suggest that this increase should include an allocation of 30 MMcf/d from SoCalGas' excess turned back capacity and the other 30 MMcf/d should come from a trade with SDG&E of El Paso for Canadian capacity. The justification given by the EGs and CMTA is that this increased core capacity would allow SoCalGas to meet core customers' cold year requirements and would diversify SoCalGas' supply portfolio. However, SoCalGas, in its reply brief, argues against this swap because SDG&E took the Canadian capacity for its own needs, SDG&E's contract for Canadian capacity is longer than SoCalGas's turned back contracts, and the swap would result in increased costs for SDG&E customers for no reason.

In addition, SoCalGas replies that it does not need more interstate capacity at this time. SoCalGas is following the Commission's 2000 and 2001 determinations on the amount SoCalGas needs to hold for its core. ORA opposes SCGC's swap recommendation as being beyond the scope of this proceeding, as does TURN. Both consumer groups opine that the BCAP is the appropriate forum to set a new capacity standard. The EGs' reply suggests that this type of reallocation is nothing more than long-term releases of capacity—a topic that is within the scope of this proceeding.

SoCalGas and SDG&E filed their BCAP applications in September of 2003, A.03-09-008 and A.03-09-003, respectively, and, as referenced earlier, the Commission intends to open an OIR and/or OII on the utilities' long-term procurement needs. Interested parties will have an opportunity in 2004 to develop a record on this point in one, or the other proceeding. We therefore find

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that the record does not support ordering SoCalGas to increase its core holdings at this time.

3. Allocation of Stranded Costs

a) Newly Acquired Turned Back El Paso Capacity

As stated previously, SoCalGas proposes allocating the stranded costs of the newly acquired El Paso turned back capacity to all its customers on an ECPT basis. ORA supports this allocation mechanism as does Edison in its capacity as a customer of SoCalGas.

SCGC, although strongly advocating reassignment of excess capacity to PG&E and SDG&E, agrees that after reassignment, the cost of excess turned back El Paso capacity that continues to be held by SoCalGas should be allocated among all its customers on an ECPT basis.

CMTA and the Electric Generators recommend that the stranded costs from the newly acquired El Paso capacity be allocated to SoCalGas' core customers. CMTA opposes allocating costs on an ECPT basis, and advocates that the Commission require SoCalGas to reallocate excess capacity to wholesale customers and assign the costs of un-reallocated El Paso excess capacity exclusively to core customers. The EGs argue that noncore customers are already bearing more than their fair share of SoCalGas's stranded El Paso pipeline costs through the ITCS for the pre-existing 406 MMcf/d, so it would be equitable for the core to pay for the stranded costs associated with the newly acquired El Paso capacity.

Recommending the opposite approach, TURN suggests allocating the stranded costs to SoCalGas' ITCS account for recovery from noncore customers. TURN supports having core customers pay in full for capacity they utilize, but since it is primarily the noncore customers who benefit from the stable border prices the excess capacity insures, noncore should pay

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the stranded costs from that excess capacity. However, TURN prefers that the Commission adopt a consistent allocation mechanism for all of the utilities, so if an ECPT is adopted for SoCalGas, TURN recommends it be the same for all the utilities.[4] For the other utilities, TURN approves having the utility determine what the core needs are and assign that to core and have core pay for it, or having all customers of all the utilities pay on an ECPT basis.

SPUR/ABAG POWER do not take a position on SoCalGas' proposed cost allocation approach, but recommend that whatever allocation approach is adopted should not have core aggregation customers bearing a greater burden for stranded costs than SoCalGas' core customers.

Southwest, as a noncore wholesale customer of SoCalGas with a customer base of core customers, is concerned that if TURN's recommendation to have noncore customers pay for the excess capacity costs were adopted, it would impact Southwest's residential customers more severely when compared with other residential customers of the other California utilities.

The Commission finds it is reasonable to allocate the stranded costs of the newly acquired El Paso interstate excess capacity to all of SoCalGas's customers on an ECPT basis. As discussed above, this excess capacity neither benefit, nor burden, any one customer class more than others, and by having all customers pay the cost is spread over a wider ratepayer base.

b) Pre-Existing Excess El Paso Capacity

Since January 2, 2002, only the noncore customers of SoCalGas have been paying the stranded costs from the pre-existing excess El Paso capacity. The Commission's decision in the Gas Industry Restructuring (GIR) proceeding, D.01-12-018, adopting the Comprehensive Settlement Agreement

[4] TURN does recommend that an exception be made for PG&E and the capacity purchased by PG&E should be assigned on a seasonal basis to core customers, as recommended by ORA.

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(CSA) with modifications, provided for the core to be relieved from any responsibility for this pre-existing capacity. Following the issuance of D.01-12-018, SoCalGas filed AL 3104 to end the core's contribution on January 2, 2002. However, due to delays in full implementation of D.01-12-018, on February 27, 2003, the Commission approved Resolution G-3334, denying all ALs except No. 3104, and directing SoCalGas to file an application to implement the CSA. SoCalGas filed A.03-06-040 on June 30, 2003. Pending full resolution of the controversy concerning the implementation of the CSA, SoCalGas proposes that Resolution G-3334 be voided, and the stranded costs associated with the pre-existing El Paso capacity be allocated on an ECPT basis to all customers, including the core.

The EGs propose that the core should pay 100% of any stranded costs associated with the newly acquired 139 MMcf/d of turned back capacity. The EGs agree with SoCalGas that the noncore have not seen the benefits of the CSA, but do not join SoCalGas in asking the Commission to void the one element of the CSA that is in effect. Most certainly, the EGs do not adopt TURN's proposal of having the noncore pick up the entire cost.

ORA argues against any proposal to abrogate the CSA because any consideration of the CSA is outside the scope of this proceeding and is already subject to another proceeding, A.03-06-040. TURN agrees that any consideration of the CSA is outside the scope of this proceeding, and D.01-12-018 is the end product of 10 years of litigation and history. TURN pleads that elimination of the core contribution to the ITCS with the adoption of the CSA was an important policy decision, and there is no justification for reversing the Commission's policy.

SCGC suggests that SoCalGas' proposed direct assignment with credit mechanism for the newly acquired turned back El Paso capacity be

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applied to SoCalGas' existing excess capacity so that customers could get a credit against the ITCS.

The Commission agrees with ORA that this is not the appropriate proceeding to revisit the CSA, including undoing the one aspect of the CSA that has been implemented; i.e., the core no longer has responsibility for the costs of the excess pre-existing El Paso capacity. We do not vacate Resolution G-3334. However, we do make a clear distinction between the pre-existing excess El Paso capacity, and the newly acquired turned back capacity. Resolution G-3334 is the Commission's current policy concerned the pre-existing excess El Paso capacity and we are not changing the noncore's responsibility to pay those stranded costs. In this proceeding we are establishing the policy for payment of the costs associated with the newly acquired El Paso excess capacity and find that it is reasonable to have these stranded costs allocated to all customers on an ECPT basis.

F. Adjustment to Gas Cost Incentive Mechanisms

In the scoping memo issued for Phase II of this proceeding, parties were directed to address whether or not the utilities' Gas Cost Incentive Mechanisms (GCIM) needed to be adjusted to properly account for both pre-existing and newly acquired interstate capacity.

SoCalGas proposes no changes or adjustments for the newly acquired capacity since SoCalGas' GCIM already provides that interstate capacity charges assigned to the core will be flowed through as a ratepayer cost as long as total transportation does not exceed transportation necessary for retail core load. SDG&E's Gas Procurement Performance Based Ratemaking (PBR) mechanism already treats firm pipeline transportation charges as a pass-through. No changes are necessary for either SoCalGas' GCIM or SDG&E's PBR.

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During the course of the proceeding, PG&E entered into two stipulations, one with ORA, and one with TURN that addressed all the contested issues involving PG&E. PG&E recommended adjustments to its Core Procurement Incentive Mechanism (CPIM) to accommodate the new El Paso capacity, and ORA agreed to them.

We find that the Stipulations with ORA and TURN are in the public interest and we adopt them as part of this decision. PG&E's El Paso costs are currently being recovered from all customers on an ECPT basis in accordance with Resolution G-3339, issued December 19, 2002, subject to reallocation after a decision in this proceeding. Since we find that the costs of PG&E's El Paso capacity should be allocated to its core customers, the noncore PG&E customers, including its core aggregation customers, are entitled to a refund for costs paid by the noncore customers. PG&E should file an Advice Letter with the Energy Division, within 60 days of the effective date of this decision, setting forth a proposed mechanism for this refund to its noncore customers for costs paid by the noncore customers, and for a mechanism for the core to pick up the costs refunded to the non-core customers.

No other adjustments to the GCIMs are necessary at this time.

G. Date for Recovery of Costs for Turned Back Capacity

Following the issuance of D.02-07-037, SoCalGas filed AL 3187, Edison filed AL 1644-E, SDG&E filed AL 1344-G, and PG&E filed AL 2434-G with the Commission's Energy Division seeking authorization to establish a memorandum account to book the costs of the newly acquired El Paso capacity. The utilities are now proposing that this decision authorize them to recover those costs.

We find it reasonable that SoCalGas, Edison, SDG&E, PG&E, and Southwest Gas recover the costs of the El Paso capacity, net of any proceeds

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the utility booked from the brokering of any excess capacity, and net of the return of any prepayments, from their established memorandum accounts. SoCalGas should recover its costs from all of its customers on an ECPT basis, and SDG&E, Southwest Gas, and SDG&E should recover their costs from their core customers. Edison should recover its costs from its electric customers through the ERRA. These utilities should recover the costs as of November 1, 2002, the date they acquired the capacity. PG&E should recover its costs from its core customers beginning with its January 2004 monthly core procurement rate filing.

H. Releases of Capacity

Each gas and electric utility that was directed to acquire the turned back El Paso capacity is in a unique situation peculiar to that utility. SoCalGas has significant levels of excess capacity and seeks Commission approval to make short-term releases throughout the year. SoCalGas states that its core does not have a summer peak and that it can meet its storage injection targets with interstate capacity it already possesses. SoCalGas also states that it can meet winter peaks by supplementing its interstate capacity with firm storage withdrawal rights. ORA, SCGC, CMTA, and the Electric Generators all agree that SoCalGas needs flexibility for short-term capacity releases. SoCalGas also wants authorization to enter into long-term releases of its excess capacity to minimize the costs associated with this excess capacity.

SDG&E is using its turned back capacity as part of its core procurement strategy and does not need short-term or long-term release authorization.[5] PG&E is permitted to enter into short-term releases of its El Paso capacity without restriction.

The Commission is convinced that the utilities should be allowed the flexibility to exercise discretion and judgment and enter into short-term releases,

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[5] Testimony of Funke, Exhibit 3, p. 15.

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defined as a term of one year or less, of their excess capacity, within California or to California customers, when they do not need to utilize all their capacity rights. Revenues from the brokering of excess capacity should be used to off-set stranded costs. Long-term capacity releases, defined as a term of one year or longer, will not be authorized at this time. While the Commission understands that long term contracts may allow a utility to obtain a higher value for the contract price, allowing long-term releases might defeat the Commission's purpose in having the excess capacity available as a protection against volatilities in the gas supply market. This is a subject that should be revisited as time passes and circumstances change in gas supplies, customer usage, energy efficiency results, diversification of fuel supplies, use of renewables, pipeline development, opening of new fuel markets, and the electric generation market. The Commission may give further guidance in the OIR and/or OII that it initiates in 2004 on the utilities' long-term procurement needs.

I. Transwestern Pre-Existing Capacity on PG&E System

When D.02-07-037 was issued on July 27, 2002, PG&E already had stranded costs from excess capacity on the Transwestern pipeline. While directing the utilities to sign up for turned back capacity on the El Paso pipeline, D.02-07-037 stated that to the extent the utilities complied with the decision, the utilities would be guaranteed cost recovery for El Paso capacity AND for existing capacity rights on other interstate pipelines.

Meanwhile, TURN filed a timely application for rehearing of D.02-07-037, specifically challenging the portion of the decision authorizing recovery of costs for existing interstate capacity. TURN argued that D.02-07-037 was issued without notice and opportunity to be heard on the topic of existing capacity, and in particular about PG&E recovering its Transwestern costs. In D.03-04-061, the Commission granted TURN a rehearing and provided an

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opportunity for additional comments by the parties on the issue of PG&E's recovery of existing gas transmission subscription costs, including the Transwestern costs.

Hearings were scheduled for June 19, 2003, on the rehearing issue, and testimony was served by PG&E and TURN. No other party participated in the rehearing. Just prior to the start of the hearing, TURN and PG&E entered into a stipulation resolving the issues on rehearing. The agreement provides that the commencement date for recovery of the Transwestern capacity costs is July 1, 2003. No party objects to the settlement, and ORA affirmatively supports it.[6]

The Commission finds the TURN/PG&E stipulation reasonable and in the public interest and adopts it, making the commencement date for recovery of the Transwestern capacity costs July 1, 2003. The stipulation is a fair compromise; the ratepayers receive the protection of not paying for the capacity costs earlier than they otherwise might have, and PG&E recovers the costs as of a date certain.

J. Strategic Storage Reserve

TURN proposes that the Commission establish a California Strategic Natural Gas Reserve to ensure reliable gas service for electric generation customers. TURN fears that unless the Commission restricts SoCalGas from releasing excess capacity to non-California shippers, there will be no insurance that the capacity is available for the state's benefit. Therefore, TURN recommends that the Commission order SoCalGas to use at least a small portion of the turned back capacity to fill some of the company's newly expanded

[6] ORA and PG&E entered into a settlement of all the issues concerning El Paso turned back capacity as well as the Transwestern costs. ORA's agreement with PG&E was that PG&E could begin recovering the Transwestern capacity costs through the CPIM beginning November 1, 2002. ORA agrees that the TURN/PG&E settlement agreement for the rehearing on the Transwestern recovery issue supersedes the ORA/PG&E agreement, and PG&E may recover Transwestern costs as of July 1, 2003.

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unbundled storage with a Strategic Natural Gas Reserve to provide for approximately 10 days of average electric generation gas burn. TURN opines that this amount of storage will protect against gas curtailments or price spikes because if a curtailment or supply shortage arose, SoCalGas would withdraw the gas for use in electric generation. SoCalGas could then easily determine how much interstate capacity would be necessary to fill the storage during the injection season. TURN recommends that the cost of the capacity in the reserve and the associated storage and carrying costs be bundled into electric generation gas rates.

TURN also proposes a priority protocol for withdrawal of the gas in storage. First priority would be given to generation plants that have tolling agreements with the Department of Water Resources (DWR) or one of the electric utilities and SoCalGas would be compensated for the gas commodity based on actual cost. Second priority would go to any other generators that would agree to sell the electricity to a utility or the Independent System Operator (ISO) at cost, and any remaining supply would be sold to other electric generators at the prevailing market price.

TURN made this proposal in its prepared direct testimony, but the concept was not fully developed during the evidentiary hearing, and there was no cross examination of TURN's witness on the reserve recommendation. In their post hearing briefs, SCGC, CMTA, and the Electric Generators raised the following concerns to the suggestion: the concept is beyond the scope of this proceeding, it is too ill-defined for consideration, there is a lack of consensus that it is needed at this time, there are questions as to who would benefit from a reserve and who should pay, and there was inadequate notice to the parties that this issue was under consideration in this proceeding. The other parties did not address the issue.

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SoCalGas initially opposed TURN's proposal, but in its reply brief suggested that this topic might have merit and should be explored in an appropriate proceeding.

In the PD, we adopted TURN's Strategic Natural Gas Reserve in principal, but deferred the details of implementation to another docket, or a subsequent phase in this proceeding. After reviewing the comments, we have determined that it is more appropriate to examine and consider the entire concept, including all aspects of its implementation in either the OIR/OII on the utilities' long-term procurement needs anticipated in early 2004, or another appropriate proceeding.

VI. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on November 24, 2003, and reply comments were filed on December 1, 2003.

VII. Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and Carol Brown is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. D.02-07-037 established two rules: (1) ordering the gas and electric utilities to sign up for a proportionate amount of turned back capacity on the El Paso interstate pipeline; and (2) finding just and reasonable and pre-approving the utilities' subscription to this turned back capacity.

2. The utilities complied with the acquisition rule ordered in D.02-07-037 and acquired the specified amounts/percentages and delivery points of turned-back El Paso capacity (see Attachment A).

3. In conformity with the acquisition rule from D.02-07-037, the utilities should continue to hold the El Paso capacity secured through the end of 2005.

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4. Edison should recover the costs of its turned back El Paso capacity from its electric customers through the ERRA.

5. Southwest Gas uses its turned back capacity for its core customers and should recover the costs of this capacity from its core customers.

6. Southwest Gas' request to be exempt from paying any of its share of the ECPT allocation to SoCalGas is not reasonable.

7. SDG&E allocated all of its turned back capacity to its core procurement department and should recover the costs of this capacity from its core procurement customers.

8. PG&E uses its turned back capacity to serve its core market and should recover the costs of this capacity from its core procurement customers.

9. PG&E should renew any short-term contracts for turned back capacity that expire before 2005, for a term that secures the capacity through the end of 2005.

10. All core aggregation customers of PG&E are due a refund for El Paso costs paid by them during the period PG&E reserved and used the El Paso capacity exclusively for the core procurement customers.

11. PG&E should make El Paso and Transwestern capacity available to its core aggregation customers under the rules adopted in the Gas Market Structure Proceeding for PG&E for 2004, A.01-10-011.

12. The Stipulations PG&E entered into with ORA and TURN for all contested issues in Phase II of this proceeding are in the public interest and are adopted because they are a fair compromise and allocate the costs of the El Paso capacity to core procurement customers since the capacity will be used to serve that market.

13. SoCalGas has 406 MMcf/d of previously acquired excess capacity on the El Paso pipeline and acquired 139 MMcf/d of turned back capacity pursuant to the order in D.02-07-037, giving SoCalGas excess capacity on the El Paso line.

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14. SoCalGas should recover the stranded costs from its excess turned back capacity from all of its customers on an equal cents per therm basis.

15. SoCalGas may make direct assignments of its turned back capacity, with the customer paying proportionate shares of receipt and delivery points for the full term at the full as-billed rate, and receiving a credit against its share of the ECPT allocation as long as the capacity stays in California.

16. SoCalGas does not need to increase its own core interstate holdings at this time.

17. Resolution G-3334, adopted February 27, 2003, giving the non-core total cost responsibility for SoCalGas' excess pre-existing El Paso capacity remains in full force and effect.

18. It is not necessary at this time to order any adjustments to the utilities' GCIM to account for pre-existing and newly acquired interstate capacity.

19. SoCalGas, SDG&E, Southwest Gas, and Edison are authorized to recover the costs associated with the acquired turned back El Paso capacity as of November 1, 2002, the date they acquired the capacity.

20. PG&E is authorized to recover its costs associated with its acquired turned back El Paso capacity on an ECPT basis in accordance with Commission Resolution G-3339, issued December 19, 2002.

21. PG&E's non-core customers and its core aggregation customers are entitled to a refund for costs they paid for the El Paso turned back capacity and PG&E's core customer should pick up the refunded costs.

22. The utilities may enter into short-term releases of their excess capacity for one year or less, but no long-term releases are justified at this time.

23. The TURN/PG&E stipulation agreeing the commencement date for recovery by PG&E of its Transwestern capacity costs is July 1, 2003, is reasonable and in the public interest.

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Conclusions of Law

1. It is reasonable to require the utilities to continue to hold the amount of capacity as ordered in D.02-07-037, by renewing El Paso contracts, unless their renewal requires an extension beyond December 31, 2005, in which case a utility may replace the expiring capacity through other contracts.

2. It is reasonable that the utilities recover the costs of their turned back El Paso capacity from their customers that use the capacity. Therefore, Edison should recover its costs from all its customers, Southwest Gas, SDG&E, and PG&E should recover their costs from their core procurement customers, and SoCalGas should recover its costs from all of its customers on an equal cents per therm basis.

3. Any utility that takes a direct assignment of SoCalGas's excess El Paso capacity should receive a credit against that utility's ECPT allocation to SoCalGas as a wholesale customer as long as the capacity stays in California.

4. Short-term releases of a term of one year or less of excess capacity are reasonable, but it would not comport with D.02-07-037 to allow long-term releases at this time.

5. The record does not support the establishment of a Strategic Gas Storage Reserve in this proceeding.

O R D E R

IT IS ORDERED that:

1. The cost allocation methodologies, and dates for cost recovery, for Pacific Gas and Electric Company (PG&E), Southern California Gas Company (SoCalGas), Southern California Edison Company (Edison), Southwest Gas Company (Southwest Gas), and San Diego Gas & Electric Company (SDG&E) for the costs of the turned back capacity on El Paso Natural Gas Company's (El Paso)

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interstate pipeline that the utilities were ordered to procure pursuant to Decision (D.) 02-07-037, as set forth herein, are adopted; Edison is to recover its costs from electric customers through the ERRA as of November 1, 2002; Southwest Gas is to recover its costs from its core procurement customers as of November 1, 2002; SDG&E is to recover its costs from its core procurement customers as of November 1, 2002; SoCalGas is to recover its costs from all of its customers on an equal cents per therm basis (ECPT) as of November 1, 2002; and PG&E is to recover its costs from its core procurement customers.

2. PG&E, Southwest Gas and SDG&E shall begin recovery of their costs with their respective January 2004 monthly core procurement Advice Letter filings. SoCalGas shall recover its El Paso costs through their end of the year rate consolidation Advice Letter. Edison shall submit an Advice Letter within 10 days of the effective date of this decision setting forth a proposed mechanism for recovery of their costs starting January 2004.

3. PG&E shall recover its Transwestern costs beginning July 1, 2003, in accordance with the stipulation entered into with TURN.

4. PG&E, SoCalGas, Southwest Gas, Edison, and SDG&E shall continue to hold the amount of capacity as ordered in D.02-07-037, by renewing El Paso contracts, unless their renewal requires an extension beyond December 31, 2005, in which case a utility may replace the expiring capacity amounts through other contracts.

5. SoCalGas shall grant a credit to wholesale customers that take a direct assignment of SoCalGas' excess El Paso capacity, paying proportionate shares of receipt and delivery points for the full term at the full as-billed rate, for the customer's ECPT allocation to SoCalGas, as long as the capacity stays in California.

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6. The utilities may enter into short-term releases of their excess El Paso capacity, but no releases for a term of more than a year are authorized at this time.

7. PG&E shall make El Paso and Transwestern capacity available to its core aggregation customers under the terms and conditions as adopted in the Gas Market Structure Proceeding for PG&E for 2004, A.01-10-011.

8. PG&E shall refund its noncore customers, including core aggregation customers, for costs paid for the El Paso turned back capacity by the noncore customers, and PG&E's core customers should pick up the refunded costs.

9. PG&E shall file an Advice Letter with the Energy Division, within 60 days of the effective date of this decision, setting forth a proposed mechanism for refunding the amounts due plus interest to the non-core and core aggregation costomers and a mechanism for placing the refunded costs into rates for the core customers.

10. Edison, Southwest Gas, SoCalGas, SDG&E, and PG&E shall continue to file quarterly compliance reports with the Energy Division as directed in D.02-07-037.

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11. Edison, Southwest Gas, SoCalGas, SDG&E, and PG&E shall file compliance reports with the Energy Division when each utility renews capacity, as ordered in D.02-07-037, and continued through 2005 in this decision.

12. This proceeding is closed.

This order is effective today.

Dated January 22, 2004, at San Francisco, California

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners

I will file a concurrence.

/s/ LORETTA M. LYNCH
Commissioner

D0401047 Attachment A El Paso Pipeline Capacity Obtained by Utilities

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