BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Consider the Annual Revenue Requirement Determination of the California Department of Water Resources and related issues.	Rulemaking 11-03-006 (Filed March 10, 2011)

PACIFIC GAS AND ELECTRIC COMPANY REPLY COMMENTS

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Order Instituting Rulemaking to Consider the Annual Revenue Requirement Determination of the California Department of Water Resources and related issues.	Rulemaking 11-03-006 (Filed March 10, 2011)

PACIFIC GAS AND ELECTRIC COMPANY REPLY COMMENTS ON ASSIGNMENT OF COSTS UNDER TRANSPORTATION SERVICES AGREEMENT BETWEEN DWR AND THE KERN RIVER GAS TRANSMISSION COMPANY

Pursuant to the procedural ruling of Assigned Administrative Law Judge Wilson dated November 20, 2012, PG&E hereby submits its reply comments in the above-captioned matter. The sole issue is whether the Commission should reallocate costs being incurred under the restated firm gas transportation service agreement between Kern River Gas Transmission Company (Kern) and DWR, dated as of August 28, 2003, and subsequently restated (TSA). These costs have been historically incurred by SDG&E and there has been no change in the relevant terms of the TSA since inception.

I. SUMMARY OF REPLY: THE COMMISSION SHOULD NOT REVISIT LONG ESTABLISHED DWR COST ALLOCATIONS THAT HAVE BEEN FINALIZED BY D. 08-11-056 AND AN IMPLEMENTING AGREEMENT AMONG THE IOU'S

Since the end of 2003, all costs and benefits under the TSA, as well as administrative responsibilities, have been assigned to SDG&E.[1] Also, from inception, the term of the take-or-pay obligations under the TSA ran through May, 2018 while the term of a related power purchase agreement that had also been assigned to SDG&E (the "Sunrise PPA) ran through June,

[1] See SDG&E Data Request #1 to DWR, dated November 30, 2012, question 6.

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2012.[2] Even though these contract terms have been in existence since inception, and full administrative and cost responsibility under these contracts has been assigned to SDG&E since the end of 2003, SDG&E now asserts that cost responsibility under the TSA should be reassigned among all utilities.

The Commission has expressed a desire to avoid revisiting allocation matters and to avoid non-productive litigation of the allocation of DWR contracts and contract costs.[3] D.08-11-056, and the implementing advice filing agreed upon by all IOUs (the "Joint Utility Advice Filing"), were intended to bring finality to these issues once and for all by requiring that all DWR contract costs, whether classified as "avoidable" or "non-avoidable," would follow the utility assigned administrative responsibility under the contract ("costs follows contract" or CFC).[4] As the administrator of the TSA, SDG&E, therefore, remains responsible for the costs under the TSA, however they are classified. Despite SDG&E's fourteen page brief, there has been no change since D. 08-11-056 (or since inception in 2003, for that matter) in the relevant contract terms or obligations under the TSA, or under the related PPA. Consistent with the Commission's desire to bring finality to these matters, there is absolutely no reason to revisit previously established and agreed upon allocations at this late date in the DWR contracting era.

SDG&E's principal argument for cost reallocation at this late date relies on DWR's dashed "expectation" that the TSA would be reassigned to Sunrise or one of its affiliates, after termination of the Sunrise PPA.[5] But an expectation that something will be done does not equate to a legal obligation that something will be done, as SDG&E should be well aware. The

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[2] See Memorandum of DWR, dated November 26, 2012 (DWR Memorandum).

[3] See D. 05-06-060, p. 5.

[4] Jointly filed: SDG&E Advice Letter 2051-E (U902-E); PG&E Advice Letter 3384-E (U39-E); and SCE Advice Letter R 2304-E (U338-E) [Joint Utility Advice Filing].

[5] See, e.g., SDG&E Opening Brief (OB), p. 3 and p. 6.

Agreement on Reassignment, dated as of September 1, 2003 (Reassignment Agreement) is not signed by Kern River Gas Transportation Company, who must accept an assignment for it to be effective; it is not signed by the co-owners of Sunrise (Chevron and Edison Mission Energy) who SDG&E asserts are alternative obligors; and it does not by its specific terms utilize a "make whole" provision (or "back to back agreement") to place the parties in a similar economic position as "expected" by an assignment, should a legal assignment not be effectuated. [6]

SDG&E, its affiliate Southern California Gas Company, and its parent Sempra Energy, are hardly neophytes in the energy contracting business. There is good reason why the Commission's policies have sought, since 2003, to substitute the utilities for DWR in contracting administration and other responsibilities, and to ultimately encourage the removal of DWR as a contracting party through contract novations in D. 08-11-056.[7] SDG&E, and not PG&E or SCE, has been the assigned utility to administer the TSA since 2003 <u>and SDG&E knew or should have known that if the TSA became undesirable there was a risk that Sunrise may refuse to accept assignment, leaving SDG&E responsible under the terms of the TSA</u>. It is far too late for SDG&E to complain now about these circumstances.

SDG&E's position for cost reallocation also is contrary to Commission objectives to match DWR contract costs and benefits with a single utility so that those contracts can be efficiently and effectively managed, and if possible, novated.[8] Here, should there be excess transport capacity, SDG&E and its commonly owned affiliates, including So Cal Gas and

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[6] A "back to back" agreement would have obligated Sunrise to pay the Kern pipeline charges to DWR and DWR would have been obligated to act as directed by Sunrise in utilizing such pipeline capacity. While DWR still would have been exposed to credit defaults by Sunrise, this kind of mechanism is sometimes used in an effort to place parties in an analogous position to a full novation (i.e., an assignment with a release of the original counter-party).

[7] Also see discussion of the utilities taking over management of contracts in D. 02-09-053, mimeo, pp. 1-18 and pp. 46-52.

[8] D. 08-11-056, mimeo, p. 3.

Sempra Energy, are well suited to find alternative uses for such capacity, and or negotiate revised contract terms with either Sunrise or Kern that could be mutually beneficial. Alternatively, the TSA could be novated in its entirety to SDG&E, to remove DWR as a counter-party. In contrast, SDG&E's proposal to entangle three different utilities in this effort would be dilutive, inefficient as to contract management, and counterproductive in negotiations. Moreover, by re-instituting an allocation of the contract costs, contrary to the comprehensive cost follows contract (CFC) regime established by D. 08-11-056, SDG&E's proposal would undermine the ability to novate the TSA, which was a stated reason for the Commission's transition to a comprehensive CFC methodology.[9]

Finally, while PG&E believes there is good reason to reject SDG&E's claims outright so as to bring finality to this process, the Commission as a second best alternative could simply decide, *based on SDG&E's own allegations,* that SDG&E's possible claim is not yet ripe for resolution. There is a well-founded legal doctrine that tribunals do not address matters that could become moot based on subsequent developments. Here, a large part of SDG&E's claim for cost reassignment relies on its assertion that Sunrise is in breach of the Reassignment Agreement, which would give DWR (and derivatively SDG&E) grounds for recovering as damages all of their losses since the termination of the Sunrise PPA.[10] If, as a result of such alleged breach, a total recovery were to occur, there would be no need to resolve the current allocation dispute, since SDG&E would ultimately recover its losses. Alternatively, if Sunrise is found **not** to be in breach, then a large part of SDG&E's argument for cost reassignment would be rendered moot. Either way, the issues for Commission resolution would go away or be substantially narrowed.

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[9] "Parties generally agree that an impediment to the IOUs entering into negotiations to execute a new contract to replace a novated DWR contract up until now has been how the resulting contract costs could be allocated among the IOUs and their customers in an equitable manner." D. 08-11-056, mimeo, p. 54.

[10] See SDG&E OB, pp. 3, 6 and 11-12.

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If, by using SDG&E's claims of a breach of contract, the Commission were to defer final resolution under this "ripeness" alternative, the Commission must also continue in the interim to allocate ongoing TSA costs solely to SDG&E, which follows from the assignment of these costs to SDG&E since 2003, the continued assignment of TSA costs by DWR to SDG&E's accounts (as stated in DWR's memorandum of October 26, 2012) , SDG&E's role as long-standing administrator of the TSA, and the Commissions' now comprehensive CFC methodology adopted in D. 08-11-056 and the Joint Utility Advice Filing. Such an ongoing assignment of TSA costs is also necessary to allow DWR to fully recover its revenue requirements and to provide clear direction as to the utility responsible for mitigating costs (by using or remarketing capacity) and managing the litigation. However, because all the TSA costs (and any recoveries) would be recorded in SDG&E's utility specific balancing account (USBA), the Commission under this alternative could then afford SDG&E the opportunity to pursue this matter with the other IOU's at a later date, when the litigation associated with the alleged contract breach is resolved.

II. SPECIFIC RESPONSES TO SDG&E

A. SDG&E's strained and illogical interpretation of the CFC methodology should be rejected (pp. 5-6)

SDG&E's first substantive argument asserts that because the PPA with Sunrise has terminated, the costs associated with the TSA have no contract "to follow." SDG&E calls these costs "orphaned" because the related PPA no longer exists.[11] SDG&E's claims are illogical and contrary to both D. 08-11-056 and their agreement implementing D. 08-11-056.

D. 08-11-056, and the Joint Utility Advice Filing, sought to once and for all allocate <u>all</u> DWR contract costs to the utility administering the contract, with indifference payments to make that utility whole, in the case of unavoidable costs that otherwise would have been shared. The utility advice filing of December 22, 2008 states that henceforth:

[11] SDG&E OB, p. 5.

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> "Avoidable" DWR contract costs will continue to be allocated on a CFC basis as is currently required under D. 05-06-060. *"Unavoidable" DWR costs will be allocated to the IOU that administers the subject DWR contract.*[12]

It is clear, therefore, that after 2008 the parties intended that all contract costs would follow the IOU that administered the contract. It is also clear that SDG&E, and not any other utility, was the IOU administering the TSA.[13] The fact that the Sunrise PPA might have been scheduled to terminate earlier than the related TSA does not give SDG&E license to now claim that administrative or cost responsibilities of a contract long assigned to them should now be re-assigned. Moreover, it is illogical to believe the parties would have knowingly intended to leave DWR contact obligations open to future reallocations, without specific mention, as this joint utility agreement, reflected in the Joint Utility Advice Filing, was intended to eliminate such disputes. As the IOU responsible for administering the TSA, it was SDG&E's responsibility to raise any and all concerns with its contracts at the time of the December 22, 2008 Joint Utility Advice Filing.

SDG&E also cannot escape responsibility, as it next asserts, based on DWR's expectation that the TSA would be assigned or on account of an alleged Sunrise breach.[14] As already noted, as a sophisticated IOU, SDG&E must know it can only rely on contractual terms, not "expectations" of DWR. Moreover, if SDG&E is correct that Sunrise is in breach of its obligations, SDG&E (through DWR) should in fact be entitled to recover as damages all of its alleged losses. Such a recovery would leave no costs to be reallocated. Finally, if the other IOUs had suffered a breach of one of their assigned contracts after 2008 (e.g., through a failure to deliver energy or supply gas), they and they alone would have been responsible to recover

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[12] Joint Utility Advice Filing, p. 3 (Emphasis Added.)

[13] SDG&E Data Request #1, Q. 6.

[14] SDG&E OB, p. 6.

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damages and could not have sought indemnification from the other IOUs. Consequently, it is inequitable for SDG&E to now seek indemnification from the other IOUs in this instance of alleged breach.

B. SDG&E's argument that the TSA costs are non-avoidable is irrelevant (pp. 6-10)

In the next section of SDG&E's brief, SDG&E asserts that the costs under the TSA are "non-avoidable" and should be allocated to all utilities, citing D. 05-06-060.[15] As a basis for reallocating costs now, SDG&E further asserts:

> In applying the foregoing rules to costs incurred under TSA 1724, the Commission must determine whether those costs are "variable" or "fixed. [16]

SDG&E is wrong. Perhaps because of its misreading of D. 08-11-056, SDG&E's opening comments fail to address why distinguishing between fixed and variable costs would make any difference now that those distinctions have been eliminated by D. 08-11-056 and the joint utility advice filing.[17] All costs follow contract, whether avoidable or non-avoidable.

SDG&E is also wrong when it claims that the TSA is "per se above market" because it is no longer receiving electricity from DWR.[18] The TSA includes rights to pipeline capacity that could be valuable, depending on market conditions. While it may be true based on DWR settlements with Kern that the TSA was at one time above market, market conditions are, of

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15 SDG&E OB, pp. 7-8

16 SDG&E OB, p. 8.

17 See SDG&E e-mail dated January 7, 2013, requesting permission to file revised opening comments.

18 Id.

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course, subject to change.[19] Having managed this contract for almost ten years, and having known that by its terms the contract extended through 2018, SDG&E should not look to the other utilities for relief based on current market conditions. This is especially true after the finality envisioned by D. 08-11-056 and the Joint Utility Advice Filing, which provided agreed upon indifference payments to substitute for any unavoidable obligations.

SDG&E's remaining citations in this section of its brief, re-arguing the classification of TSA costs as non-avoidable or avoidable, all relate to other cases, decided before D. 08-11-056 and its implementing Joint Utility Advice Filing, which rendered these contract cost distinctions irrelevant going forward. SDG&E's analysis of the individual cases is also flawed. For example, the Commission's earlier allocation of hedging costs (and benefits) to all parties was based on the underlying cost being hedged (e.g., a gas cost) also being allocated to all parties on the same basis.[20] Here, the TSA cannot be a similar hedge, as there is no similar underlying DWR contract cost to hedge that is being spread among all utilities after implementation of D. 08-11-056. SDG&E's analysis of the Williams Gas allocation decision is also flawed, because the decision specifically relied on the fact that the Williams Gas contract resulted from a unique settlement, and treated the obligations as unavoidable from the outset.[21] Here, the essential terms of the TSA, including contract costs that have been always been treated as "avoidable," did not result from a settlement of claims but from arms-length negotiations between DWR and Sunrise during 2002-2003. Even if classification of costs somehow remained

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[19] SDG&E also implies that because settlement proceeds in 2008 and 2010 were shared using the fixed percentages, contract costs under the TSA also should be shared, ignoring the fact that it is also true that TSA costs have not been shared since 2003 (i.e., all costs have been allocated to SDG&E). PG&E expresses no opinion at this time whether the different treatment of settlement proceeds and contract costs was reasonable, except to note that since 2004 virtually all settlement proceeds have been allocated using the fixed percentages adopted in D. 05-06-060.

[20] See D. 05-12-010, mimeo, pp. 3-4.

[21] See D. 06-11-003, mimeo, p. 5.

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relevant contrary to D. 08-11-056, SDG&E has identified no authority to reclassify costs as "non-avoidable," once they have been classified as "avoidable."

C. Equity does not require reallocation of TSA costs (pp. 10-12)

As a last ditch effort to initiate a re-assignment of contract costs, SDG&E claims that it would be inequitable to impose the remaining costs on SDG&E alone.[22] SDG&E's evaluation ignores the fact that this is but one of many contracts that were allocated and assigned as part of the DWR process. Any effort to reassign contracts now would disturb the equities that were set forth in the permanent allocation decision (D. 05-06-060) and in D. 08-11-056 and the subsequent implementation agreement. The Commission should decline to engage in such a revision to past allocations, which would only encourage other utilities to undertake similar efforts.

PG&E, too, has complaints about this process that it would like revisited, such as the highly flawed and internally inconsistent Williams Gas decision (D. 06-11-003), which subsequent to the permanent allocation decision, forced PG&E to bear over 42.2 % of the cost of gas supplied under the Williams Gas contract, even though it received none of the supply. In that windfall, SDG&E paid only 10.2% of the costs but received 43% of the gas, and its customers, as the smallest utility disproportionately benefitted from that decision at PG&E's expense. To the extent SDG&E raises equitable concerns at this late date, it would be fair for PG&E to compile a list of its equitable concerns with the history of the DWR allocation process, and to also present those for Commission re-determination.

Finally, PG&E notes in this section of SDG&E's brief, another misinterpretation of precedent, this time involving the extinguishment, of a pre-existing, at that time beneficial,

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[22] SDG&E OB, pp. 10-12.

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Calpine contract that had been assigned for administrative purposes to PG&E.[23] While characterized by SDG&E as a "settlement," in fact this substitution of agreements was not a settlement of claims by DWR, but merely an arms-length restructuring between DWR and Calpine of an existing contractual relationship.[24] That CPUC decision on cost allocation, which was unopposed, merely affirmed the pre-existing obligations of SCE and SDG&E under the original contract, holding both SCE and SDG&E indifferent to the contract replacement, and preventing a windfall to them at PG&E's expense. [25] In contrast, in its present proposal, SDG&E seeks an actual reallocation of costs at the expense of both PG&E and SCE --- costs that neither utility has ever borne.

III. CONCLUSION

For the reasons set forth above, the Commission should reject SDG&E's efforts to alter the allocation methodology approved in D. 08-11-056, as implemented by the Joint Utility Advice Filing.

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[23] See D. 08-04-025.

[24] SDG&E OB, pp. 12-13.

[25] D. 08-04-025 at pp. 6-7. The payments that were provided by SCE and SDG&E to PG&E in D. 08-04-025 were intended to substitute for cost allocations under D. 05-06-060 that those two utilities otherwise would have incurred but for the contract restructuring (i.e., for costs that were unavoidable under the original Calpine contract). The payments were structured similarly to later "indifference payments" for unavoidable costs that also would no longer be allocated, as provided in D. 08-11-056, when the Commission moved to a comprehensive CFC methodology..

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Respectfully Submitted,

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