

Memorandum

Date: January 18, 2013

To: Honorable Michael Florio
Assigned Commissioner
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

Honorable Seaneen M. Wilson
Administrative Law Judge
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, California 94102

From: John Pacheco, Deputy Director
Department of Water Resources

Subject: Rulemaking No. 11-03-006

The California Energy Resources Scheduling division of the Department of Water Resources (“DWR” or “Department”) submits this memorandum to assist the California Public Utilities Commission (“CPUC” or “Commission”) in its determination of the allocation of costs related to the firm gas transportation agreement (“TSA”) between the Kern River Gas Transmission Company (“KRGTT”) and DWR. This memorandum will address and clarify statements made in the Investor Owned Utilities (“IOUs”) comments to the CPUC filed on January 4, 2013.

SDG&E Comments

SDG&E states that “the Department itself had considered TSA 1724 to be related to the Sunrise power purchase agreement only through the term of that agreement.” The TSA was related to the Sunrise Contract as the most cost-effective way to provide natural gas for the operation of the Sunrise power plant. The Department has followed the cost allocation decisions of the CPUC in recording the costs of the TSA. The TSA cost was allocated to SDG&E as part of the Sunrise Contract, and, even after the expiration of the Sunrise Contract, is allocated on a cost-follows-contract basis as directed in CPUC Decision 08-11-056.

SDG&E continues, “The facts before the Commission simply do not support any finding that there is an ongoing nexus between SDG&E’s prior management of the Sunrise power purchase agreement and TSA 1724.” However, during past years the costs and benefits of the TSA agreement have been allocated to SDG&E. SDG&E managed the TSA for delivery of fuel to the facility and, not infrequently over

the life of this TSA, the full capacity was not utilized by the plant. SDG&E was able to market the unused gas and obtained the benefit of those transactions. More recently, SDG&E participated in the short term release of TSA capacity for the month of January 2013 and was able to obtain the capacity at far less than the DWR cost of \$0.47 per MMBtu¹.

SDG&E also asserts that the Department, in at least in two instances, considered the costs of TSA to be above-market by using the allocation factors to record the refunds associated with TSA to all three IOUs. Contrary to SDG&E's assertion, the Department was treating these amounts as settlements resulting from FERC litigation related to excess tariff charges by KRGT and the subsequent FERC ordered refunds. This assignment was purely mechanical, as the Department has consistently recorded in the utility specific balancing accounts all litigation related revenues using the fixed percentage allocators resulting from Commission Decision 05-06-060. If the CPUC, after reviewing these two settlements concludes that different treatment is warranted, the CPUC decision will be reflected by an adjustment to the utility specific balancing accounts.

Most troubling to the Department is SDG&E's comment: "Although the Commission could consider omitting such costs from the Department's annual revenue requirement in the hope of encouraging the Department to redress the breach through all available means, SDG&E is loath to recommend the Commission incite an interagency confrontation or otherwise harm the interests of the State of California..." First, SDG&E's suggestion that the Commission could omit these costs is completely erroneous. Under California law and the Rate Agreement the respective roles of the CPUC and DWR are clearly defined. The role of the CPUC is to allocate the Department's costs by setting rates at levels sufficient to recover DWR's revenue requirements. The Department's role is to determine its costs and to notify the CPUC of the amounts required to pay for bond and power related costs. The cost of the TSA is a continuing obligation of the power program and as such needs to be appropriately allocated by the Commission. As always, the Department is willing, available, and obligated under the Rate Agreement to assist the Commission in any proceeding related to the Power and Bond Charges. Second, SDG&E's implication that the Department is somehow derelict in its pursuit of this issue and needs some encouragement to seek all available remedies is inaccurate. To the contrary the Department has and is seeking multiple avenues to resolve this issue and relieve the ratepayers of this burden brought on by Sunrise's breach. Before considering potential legal recourse, the Department requested assistance from SDG&E in continuing to manage the TSA capacity after the June 30, 2012 expiration of the power agreement. SDG&E declined to provide that assistance.

¹ SDG&E was among the bidders for the January 2013 capacity release and was awarded 25,000 dth/day in capacity at \$0.08/dth.

In fact, as noted above, SDG&E has taken advantage of the situation by purchasing the TSA capacity in the secondary market at pennies on the dollar.

SCE and PG&E Comments

SCE mentions an allocation of bond proceeds in its comments regarding the “disproportionate burden of DWR’s costs.” However, there has not been an allocation of bond proceeds to any IOU. Bond proceeds were used to establish reserve levels, reimburse California’s General Fund and repay an interim loan associated with the Department serving as the power provider of last resort and supplying power to the customers in the IOU service areas. At no time were bond proceeds allocated or assigned to an IOU.

Both SCE and PG&E question whether in fact the Agreement on Reassignment has been breached. This is not for the Commission to decide as it is a contractual matter between the Department, acting on behalf of the ratepayers, and Sunrise. The Department believes that Sunrise has breached the Agreement on Reassignment which clearly ties the length of the assignment of the TSA to the term of the Sunrise Contract.

General Comments

The Department fully expected Sunrise to comply with its obligations to take assignment of the TSA in accordance with the Agreement on Reassignment dated September 5, 2003. Sunrise failed to do so, and its affiliates, Edison Mission Energy and Chevron, declined to step in and relieve the Department and ratepayers of this continuing obligation.

It would be very helpful to the Department and beneficial to the ratepayers if the IOUs, DWR and the CPUC could coordinate their efforts to find a solution to this matter. The Department would appreciate the IOUs’ involvement to determine: (1) the most efficient use of the 85,000 MMBtu/day capacity on the KRGT pipeline; and (2) how best to manage the costs to ratepayers by Sunrise’s refusal to accept reassignment.

Because the KRGT pipeline capacity can deliver into the SoCal Gas and PG&E service territories, the Commission should consider whether the assumption of the TSA by an IOU or IOUs would be in the best interest of the ratepayers. The IOUs that have demonstrated a need for the transmission capacity are in a better position to mitigate any potential losses.

Certainly, there may be other market-based or practical solutions that the Department has not yet envisioned. Otherwise, it is likely that significant additional costs will be incurred by ratepayers to either reach resolution through the court system, or pay the ongoing costs through the end of the TSA term. The bottom line

is that the Department does not have any power purchase agreements remaining that could effectively utilize gas from this pipeline and therefore has very limited ability to mitigate damages.

DWR appreciates the Commission's assistance in implementing the Department's Revised Revenue Requirements Determination for 2013, especially as most of the Department's power purchase contracts have expired and the amount of energy from which to collect power charges has diminished.

If you have any questions or need additional information, please contact me at (916) 574-0311.

/s/ John Pacheco

John Pacheco
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California Energy Resources Scheduling