**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<br>(Filed March 10, 2011) |
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# PACIFIC GAS AND ELECTRIC COMPANY OPENING COMMENTS


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

## I. INTRODUCTION

Pursuant to the procedural ruling of Assigned Administrative Law Judge Wilson dated November 20, 2012, PG&E hereby submits its opening comments in the above captioned matter. The sole contested issue is whether the Commission should reallocate to all utilities, contract obligations (and rights) under the firm gas transportation service agreement between Kern River Gas Transmission Company and DWR (TSA) that had been previously assigned to San Diego Gas and Electric Company (SDG&E).

## II. EXECUTIVE SUMMARY: SDG&E'S POSTION TO SPREAD COSTS OF THE TSA AMONG ALL UTILITIES IS CONTRARY TO PRECEDENT AND INCONSISTENT WITH COMMISSION POLICY

PG&E understands that SDG&E will assert that TSA costs (and rights) that have been assigned to them historically now must be shared among all utilities because a related power purchase agreement is no longer is in effect. While the terms of the TSA extend beyond the period of related power agreement, and DWR's obligations thereunder extend as well, PG&E is aware of no precedent for SDG&E's claims that the Commission should now reallocate obligations under a contract that has been previously assigned entirely to one utility. To the



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contrary, the last two Commission allocation decisions -- D. 05-06-060 (the "Permanent Allocation Decision)" and D. 08-11-056 (the "Decision to Facilitate Contract Novations') -- made clear that the Commission envisioned assignments of rights and obligations under contracts to be permanent and that it intended placing obligations under a single contract with a single utility to encourage efficient management of those contracts and possible novation. SDG&E's apparent theory that this assignment of rights and obligations should now be revisited runs directly counter to this precedent and should be rejected.

Further, as discussed below, PG&E is not aware of any valid factual or other basis for ignoring or altering that precedent. The treatment by DWR of a past settlement amount and the possibility that obligations under the contract may have been voluntarily assumed by another party provide absolutely no justification for revisiting the Commission's permanent allocation methodology.

## III. FACTUAL BACKGROUND: THE RIGHTS AND OBLIGATIONS UNDER THE TSA HAVE BEEN HISTORICALLY ASSUMED BY SDG&E

Documents provided by DWR show that Edison Mission Energy (EME) and Kern River Gas Transportation Company (Kern) entered into a gas transport agreement on May 29, 2001. On December 31, 2002 DWR and Sunrise Power Company (Sunrise), a subsidiary of EME, entered into a power purchase agreement (PPA) that was to terminate on June 30, 2012. On April 4, 2003, EME novated its gas transport agreement with Kern to Sunrise and on August 28, 2003 Sunrise novated that contract (now, the "TSA") to DWR. The TSA provided for firm transportation rights on the Kern pipeline in exchange for scheduled payments, as provided in Article II of the TSA, ***and extended from September 1, 2003 through April 30, 2018.***

As part of its execution of the TSA, DWR separately agreed with Sunrise in an Agreement on Reassignment, dated as of September 1, 2003 (the "Reassignment Agreement") that DWR's *rights* to firm transportation under the TSA were associated with the PPA and would



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not exceed the term of the PPA (including any extensions thereof) and that it would use best efforts to assign the TSA back to Sunrise or an affiliate of Sunrise upon termination of the PPA, all such assignments being subject to approval by Kern. *No explicit obligation was imposed on Sunrise within the Reassignment Agreement to accept the re- assignment from DWR.* Nor was any affiliate of Sunrise made a signatory to such agreement.

The Sunrise PPA was first delegated to SDG&E in connection with the Commission's decision assigning rights to power and related dispatch decisions under DWR's various PPA's to the respective utilities (D. 02-09-053). DWR had originally assumed the role of contracting for power when the utilities were unable to do so financially in 2001 and 2002. The Commission's intent in D. 02-09-053 was to assign dispatch decisions over DWR's PPA's to individual utilities so power would only be generated when it was economical on a marginal cost basis to do so (i.e., when the benefit of power (price) exceeded the marginal cost of generating the power). A clear objective of the Commission also was to provide for more efficient management over the DWR contracts by centralizing day-to-day decision-making over contracts in a single utility, as power contracts had been managed in the past:

> The utilities can now move forward with their procurement planning knowing exactly what DWR contracts they will need to integrate into their resource portfolios. Today's decision eliminates the current two-tier procurement system in California that was put in place on a temporary basis, and only under emergency circumstances, until the utilities could resume their procurement role. As described in this decision, the utilities will now perform all of the day-to-day scheduling, dispatch and administrative functions for the DWR contracts allocated to their portfolios, just as they will perform those functions for their existing resources and new procurements. Legal title, financial reporting and responsibility for the payment of contract-related bills will remain with DWR. (D.02-09-053, mimeo at p. 5).

The Sunrise PPA constituted a "tolling agreement," whereby Sunrise agreed to convert gas provided by DWR (or by Sunrise, at DWR's option) into electricity. Because DWR controlled how and whether gas was delivered to the generator, it effectively controlled the decision to dispatch power. After D. 02-09-053, when SDG&E was delegated rights to Sunrise power and administrative responsibility over that contract, SDG&E then controlled the tolling arrangement, including the provision of gas, which included any day-to-day management of the TSA. From the outset, the TSA was treated as part of SDG&E's gas costs (i.e., it was treated as part of the cost of dispatch and as an "avoidable," variable cost), rather than as a "non-avoidable" cost subject to allocation.

After the delegation of contract administration and dispatch decisions in D.02-09-053, the Commission endured continuing disputes regarding the allocation of DWR contract costs. The Commission wished to foreclose such disputes. In D. 05-06-060, the Commission issued its permanent allocation decision, recognizing that its allocations were largely a zero sum game and intending that its allocations would be final. In that decision, which modified an earlier decision that had been supported by PG&E and SCE, the Commission largely adopted SDG&E's proposed framework, classifying DWR's costs as non-avoidable or avoidable. Non-avoidable costs were allocated among all utilities in accordance with the fixed percentages while avoidable costs were assigned to specific utilities. Consistent with the treatment of gas costs in the Commission's earlier decision, gas costs associated with the TSA were treated as part of the cost of dispatch (avoidable) and continued to be assigned to SDG&E, rather than constituting an "unavoidable" cost subject to allocation.

Subsequently, the Commission issued its decision to facilitate novations by DWR of DWR contracts to the respective utilities receiving power under those contracts (D. 08-11-056). Since the issuance of D. 02-09-053, day to day administration over DWR contracts had been transferred to the respective utilities, but as recognized by the Commission, legal and financial responsibility (the obligation to pay) under the contracts had remained with DWR. If the



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contracts could be novated, DWR would be removed altogether as a counter-party, meaning that payments would no longer be made by DWR and the utilities would assume full financial and administrative responsibility over the contracts. The Commission wished to encourage contract novations that would eliminate all roles and responsibilities of DWR under the contracts.

The Commission recognized, however, that there was a financial impediment to novations on account of the permanent allocation methodology. Because only DWR costs were allocated as part of the DWR revenue requirement, and a novation would mean that costs under the novated contracts would no longer would be borne by DWR, the Commission recognized there would be a disconnect in the economic treatment of costs classified as “unavoidable” before and after a novation. That is, while “unavoidable” costs incurred by DWR on a contract before a novation were allocated among utilities in accordance with the fixed percentages, those same “unavoidable” costs after a novation would be incurred entirely by the utility accepting the novation, with no mechanism in place to continue the allocation process. The Commission recognized that this was an impediment to contract novation that needed to be removed.

To maintain economic indifference on the part of the utility receiving the novation, and to maintain the equities of the permanent allocation decision, the Commission initiated a two-step process proposed by SCE.[1] First, the Commission adopted SCE’s recommendation that effective January 1, 2009, the utilities would be subject to a “cost follows contract” methodology; that is all unavoidable costs DWR contract costs would be allocated to the utility that administers the contract. Significantly, the Commission’s transition to a pure CFC methodology had the effect of making each utility the full economic owner of the contract being administered by it, even if the contract was not novated. The second step was to preserve the equities of the permanent allocation decision, by requiring indifference payments to “make-up” for the allocations of

[1] D. 08-11-056, mimeo, p. 58.

"unavoidable" costs using the fixed percentages that would no longer occur under the CFC methodology. A schedule was drawn up and agreed to by the utilities of fixed payments that comprised these indifference payments and the utilities made a joint advice filing on December 22, 2008 (the "Joint Utility Advice Filing," that was later accepted by the Commission as of January 12, 2009.[2] Again consistent with past decisions, the TSA was not treated as an "unavoidable" cost subject to cost allocation, so no indifference payments were provided.

## IV. DISCUSSION: SDG&E'S PROPOSAL TO ALLOCATE COSTS (AND BENEFITS) OF THE TSA AMONG ALL UTILITIES IS CONTRARY TO PAST TREATMENT OF THESE COSTS AND ESTABLISHED COMMISSION PRECEDENT AND POLICY

### A. SDG&E's Proposal Is Inequitable Because It Seeks, Based on "Twenty-Twenty Hindsight," to Alter The Long-Standing Allocation of Benefits and Burdens of this Contract to SDG&E

To PG&E's knowledge, since the contract was first assigned to DWR in 2003, virtually all benefits and burdens of the TSA have been assigned to SDG&E. The contract, depending on market conditions, could have turned out to be beneficial and PG&E does not know whether the contract has, in fact, been beneficial to SDG&E to date. Regardless, SDG&E would not have proposed to share any net contract benefits with the other utilities. It is only long after the contract was executed and the benefits and burdens have been assigned entirely to SDG&E, and now, only after it now appears the contract rights are no longer desirable, that SDG&E now complains and seeks to revisit its assignment of the benefits and burdens. The Commission should reject SDG&E's after the fact, "heads I win, tails you lose" proposition as inequitable and unfair to other utilities that have borne the benefits and burdens of their assigned contract obligations.

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[2] 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).

### B. SDG&E's proposed treatment is also contrary to precedent, as reflected in DWR cost allocation decisions

SDG&E's proposal to allocate costs (and benefits) of the TSA to all utilities is inconsistent with precedent, as reflected in DWR cost allocation decisions.

First, the proposal is contrary to the intent of the permanent allocation decision, which was to result in a final allocation of DWR costs. Since inception the costs under this contract have been assigned to SDG&E. In its permanent allocation decision, the Commission adopted much of the allocation methodology proposed by SDG&E, and continued to assign costs and benefits under the TSA entirely to SDG&E. The Commission further stated:

> All parties agree that the allocation methodology that is adopted here should be permanent. (See, e.g., SCE Opening Brief, p. 43, PG&E Opening Brief, p. 4, SDG&E Opening Brief, pp. 2-3.) We concur. Annual litigation of the allocation methodology is not an efficient use of the parties' or the Commission's time and resources. (D.05-06-060, mimeo, p.5.)

Subsequent to the permanent allocation decision (as before it) the benefits and burdens of the TSA were assigned to SDG&E and reflected as such in the Commission's DWR cost allocation decisions. Given the clear intent of the permanent allocation decision to not revisit allocations associated with energy contracts, there is no basis for modifying such a decision that was intended to be permanent.

Second, in its decision to facilitate contract novations, the parties essentially confirmed the permanent allocation treatment by not providing for any indifference payments on account of the TSA. Had those TSA costs been spread under the permanent allocation decision (or had it been envisioned that costs would be spread in the future), indifference payments should have been provided for, as the intent was to preserve the equity of the permanent allocations, while transitioning to a comprehensive CFC methodology. As the Commission stated:

> Adopting a mechanism that preserves the existing allocation methodology, as proposed by SCE, is consistent with past Commission policy not to revisit the fixed percentages and the methodology adopted in D.05-06-060 to allocate the unavoidable costs over the life of the contracts. The previously adopted allocation methodology was "designed to be fair over the life of the contracts." D. 08-11-056, mimeo, p. 59.

The parties, however, provided for no such indifference payments in connection with the TSA, even though costs under that contract continued to be assigned to SDG&E. Moreover, the Commission's clear intent, implemented and agreed upon by the parties in their Joint Advice Filing, was to move from a procedure where only a portion of the contract costs (i.e., costs classified as "avoidable") were treated as CFC (cost follows contract) to a regime where all costs were treated as CFC. As stated in the Joint Advice Filing:

> The revised DWR cost allocation methodology adopted in D.08-11-056 maintains the equity of the permanent cost allocation methodology adopted in D.05-06-060 *by implementing a CFC methodology* with indifference payments to keep each IOU's respective customers indifferent to the attempt to novate the DWR contracts. "Avoidable" DWR contract costs will continue to be allocated on a CFC basis as is currently required under D.05-06-060. "Unavoidable" DWR contract costs will also be allocated on a CFC basis to the customers of the IOU that administers the subject DWR contract. (Emphasis added).

Since 2008, TSA costs under the CFC methodology have been assigned to SDG&E, just as they have been since the permanent allocation decision. To the extent benefits and costs under the DWR energy contracts remain in effect, there is no basis under a CFC methodology to re-allocate those costs to SCE and PG&E now. SDG&E's efforts to do so are contrary not only to the permanent allocation decision and its subsequent implementation (which resulted in assignment of these costs to SDG&E) , but also to D. 08-11-056 and the implementing Joint Utility Advice Filing, which transitioned to a comprehensive CFC methodology. So long as



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payments are required under the TSA, those costs are the responsibility of SDG&E, not of the other utilities.

### C. SDG&E's position is contrary to their agreement implementing D. 08-11-056 (the "Joint Utility Advice Filing")

In addition to being contrary to precedent, as reflected in DWR allocation decisions, SDG&E's position also should be rejected as being contrary to their agreement to the terms of the Joint Utility Advice Filing implementing D. 08-11-056. SDG&E agreed to the schedule of indifference payments and the CFC methodology. If SDG&E had concerns about the TSA, the rights and obligations of which clearly extended through 2018, it should have raised those concerns at the time of the CFC agreement. Instead, SDG&E agreed to the schedule of indifference payments as part of a final transition to a CFC regime.

SDG&E has always been the utility with assigned responsibility over the TSA. SDG&E, as the assigned utility, is responsible for understanding the legal requirements of the CFC obligations of the TSA, which included the possibility that assignment of the contract to Sunrise (or an affiliate non-signatory) would not be legally accomplished. The TSA by its terms clearly extended through 2018, and SDG&E could have sought to reserve this issue in the Joint Utility Advice Filing. The Commission should not be required to decide, nor should the other utilities be required to litigate, final allocations under a CRC methodology that was agreed upon by the parties.

### D. Finally, SDG&E's Position Is Contrary to Commission Policy To Centralize DWR Contract Management In a Single Utility

Finally, SDG&E's approach would regress from the ongoing efforts by the Commission to transfer contract administration responsibility out of the hands of DWR and into the hands of a single utility. A single utility would be better equipped to remarket the excess transportation rights and maximize the yield to customers by reaching prompt decisions regarding sub-leasing the transport rights and/or renegotiating (or buying out) the remaining terms of the contract.



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Alternatively, a single utility could negotiate collateral with Kern (along with subrogation rights in the event of default) that might allow for the TSA to be novated to Sunrise after all. In contrast, dividing responsibility among the three utilities would result in diffuse management over these issues that could result in hindering the ability to efficiently and effectively manage the contract issues. SDG&E's position also should be rejected, therefore, because it regresses from the trend of Commission decisions that have sought to centralize decision-making in a single utility and remove DWR from its administrative responsibilities over energy contracts.

## V. CONCLUSION

For reasons set forth above, SDG&E's position should be rejected as it is inconsistent with historical practice and Commission precedent and contrary to SDG&E's agreement to a schedule of indifferent payments to implement a comprehensive CFC methodology. SDG&E's position is also inequitable; as each utility has accepted benefits and burdens under their assigned contracts and had the retained transport rights remained beneficial SDG&E would not be offering now to share those benefits with the other utilities.

Respectfully Submitted,


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