

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Address Natural  
Gas Distribution Utility Cost and Revenue Issues  
Associated with Greenhouse Gas Emissions.

R. 14-03-003  
(Filed March 13, 2014)

**JOINT OPENING COMMENTS OF PACIFIC GAS AND ELECTRIC COMPANY (U 39  
E), THE OFFICE OF RATEPAYER ADVOCATES, SOUTHERN CALIFORNIA GAS  
COMPANY (U904-G), SAN DIEGO GAS & ELECTRIC COMPANY (U 902-E), AND  
SOUTHWEST GAS CORPORATION (U 905 G) ON PHASE 1 ISSUES**

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Pacific Gas and Electric Company (PG&E), the Office of Ratepayer Advocates (ORA), Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E) and Southwest Gas Corporation (Southwest Gas) (Joint Parties) submit the following Opening Comments on Phase I Issues, pursuant to the July 7, 2014, Scoping Memo and Ruling of the Assigned Commissioner and Administrative Law Judge (Scoping Ruling).

**I. INTRODUCTION AND SUMMARY**

In the Scoping Ruling, the assigned Administrative Law Judge, Julie M. Halligan, and Commissioner Peterman bifurcated this proceeding into two phases. In Phase 1, the Commission will address higher-priority issues that require prompt resolution—the rules governing procurement authority, cost recovery, forecasting and other specified issues. In Phase 2, the Commission will address remaining issues, including the use of GHG revenues and GHG outreach and education. In these comments, the Joint Parties propose that Phase 1 issues be resolved in a manner that supports statewide Cap-and-Trade objectives, is administratively efficient, and in the best interest of our customers.

Specifically, Joint Parties propose that the Commission adopt procurement rules for regulated utilities that allow flexibility to transact in the Cap-and-Trade market for the benefit of our customers, establish two-way balancing accounts for the recording of direct costs, as well as related administrative and customer outreach costs of complying with Cap-and-Trade regulations, and adopt a forecasting methodology that relies on public data so that utility forecasts can be transparent and shared with all interested parties. This proposal is consistent with the Joint Motion of Pacific Gas and Electric Company, The Office of Ratepayer Advocates, SoCalGas, SDG&E, and Southwest Gas Corporation to Adopt Settlement, filed on July 25, 2014.<sup>1</sup> In the comments that follow, Joint Parties also respond to the other remaining issues identified in the Scoping Ruling as within the scope of Phase 1.

## **II. DISCUSSION**

### **A. Procurement Authority**

The scoping memo lists three specific issues to be addressed with respect to the authority of regulated natural gas utilities to transact in the State's cap-and-trade market: (1) What authority is needed for natural gas corporations to procure Cap-and-Trade compliance instruments related to their natural gas compliance obligation?; (2) What rules and limits should govern how natural gas corporations with a compliance obligation should procure Cap-and-Trade compliance instruments and whether these rules and limits should mirror those adopted in Decision 12-04-046 for electric utilities?; and (3) Should these rules apply equally to each natural gas corporation, or should the Commission apply different rules depending on the size of the utility and whether it is an integrated electric and gas utility? SoCalGas and SDG&E address these three issues as follows.

Natural gas utilities are already under an obligation to procure Cap-and-Trade allowances for gas consumed by any compressor stations they may operate. This

<sup>1</sup> The proposed settlement addresses natural gas corporation rules and tariffs for cost recovery and purchasing of natural gas supplier compliance instruments under Assembly Bill 32.

obligation began with Compliance Period 1 in 2013 and 2014 and will continue in Compliance Period 2 and beyond. Thus, natural gas utilities with compressor stations, either have procured, or must procure some allowances in the short time remaining before the November 3, 2014 deadline. Natural gas utilities also have an obligation to procure compliance instruments on behalf of their end-users, beginning in 2015. Thus, Cap-and-Trade procurement activities by regulated natural gas utilities may already be taking place without express guidance from the Commission.

Joint Parties seek clarification of the rules governing their procurement of Cap-and-Trade compliance instruments. Specifically, Joint Parties propose that the Commission expressly authorize regulated natural gas suppliers to: (1) purchase and sell allowances through Commission-approved exchanges, brokers, and via ARB auctions<sup>2</sup>; (2) purchase offsets (including offsets where the buyer assumes the risk of invalidation) bilaterally, through brokers, and through a competitive Request For Offer (RFO) process; (3) insure or hedge (including the use of options) the invalidation risk of offsets; (4) enter into forward contracts for delivery of future purchases up to a Commission-defined limit; and (5) sell compliance instruments under well-defined circumstances.

PG&E and SDG&E propose to periodically review recent and prospective transactions with its Procurement Review Group. SoCalGas proposes to periodically review recent and prospective transactions with a comparable consultative group comprised of representatives from the CPUC's Energy Division (ED), ORA and The Utility Reform Network (TURN). Southwest Gas proposes to report any sales transactions to ORA and ED. In addition, each utility would prepare and submit to ORA and ED a confidential annual report listing its purchases and sales of all natural gas supplier compliance instruments including greenhouse gas allowances, allowance futures and forwards, and offsets and offset forwards, carbon allowance derivatives, and any agreements with counterparties to purchase compliance instruments in the future.

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<sup>2</sup> Sales via ARB auctions would be contingent on whether ARB regulations allow such sales in the future.

Further, Joint Parties recommend that the Commission not require investor-owned natural gas utilities to consign more than the ARB minimum for auction unless the utility determines that additional consignment would reasonably mitigate compliance costs for customers. These proposals are set forth in greater detail in the proposed settlement filed on July 25, 2014.

The rules adopted for natural gas utilities should not mirror the current rules adopted for electric utilities. The electric utility procurement rules were adopted prior to ARB's implementation of the Cap-and-Trade Program and include restrictions adopted in an abundance of caution for the protection of electric customers facing utility participation in an unknown market. Now that the market has been successfully implemented, some of the stringent requirements, such as requiring that offsets be acquired through a competitive RFO process, may no longer be warranted and could be costly for utilities that do not currently have a competitive RFO process in place to implement.

Access to the full range of available compliance instruments is important in order for utilities to better mitigate costs for customers. With respect to offsets, the assumption of buyer risk associated with invalidation may be reasonable given the current high cost of shifting that risk to the seller. The risk of offset invalidation can be managed through the use of hedging strategies and portfolio management. Some procurement restrictions currently imposed on the electric utilities are perceived as unworkable by many offset providers and, consequently, limit the available supply. Contracting with a limited pool is likely to increase costs to an extent not warranted by the benefits. As explained by ARB following its economic analysis of California's climate change scoping plan, "offsets can help contain costs within the cap-and-trade program and prevent higher energy prices for California's businesses and residents, allowing continued economic growth."<sup>3</sup> Joint Parties would like to see rules adopted for natural gas utilities that

<sup>3</sup> ARB's *Updated Economic Analysis of California's Climate Change Scoping Plan* at ES-6

facilitate access to ARB-issued offsets created by as large a range of developers as possible. Gas utility customers may be placed at a competitive disadvantage vis-a-vis other participants in the Cap-and-Trade Program if gas utilities are prevented from accessing the entire Cap-and-Trade market, while unregulated compliance entities are not subject to similar market participation restrictions.

Brokers are a tool widely used within other markets by traders to improve their access to other market participants. Transacting through brokers has proven effective in natural gas procurement and would improve the access of gas utilities to other participants in the allowance and offset markets. Therefore, Joint Parties seek express authorization from the Commission to transact through the use of brokers.

If this proposal is adopted, the rules would apply equally to each natural gas corporation. If the Commission adopts a more prescriptive approach, the rules may need to be tailored to accommodate the differences between natural gas corporations.

#### **B. Cost Recovery**

The scoping memo sets forth five issues to be addressed with respect to cost recovery: (1) How should each natural gas corporation with a compliance obligation track and recover costs associated with GHG Cap-and-Trade Program compliance, either as a natural gas supplier or as an owner and operator of gas compression stations that may be regulated under Cap-and-Trade as Covered Entities?; (2) What existing authority does each natural gas corporation have to track and record Cap-and-Trade costs, and what new authority is needed?; (3) How should Cap-and-Trade related [costs] be allocated between core and non-core gas customers?; (4) What tariff changes are necessary to introduce GHG costs in rates?; and (5) Should Cap-and-Trade-related costs be temporarily deferred from rates if the Commission has not resolved revenue implementation details before January 1, 2015? Joint Parties address these five issues as follows.

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(March 24, 2010).

Currently, SoCalGas and SDG&E are authorized to track and recover costs incurred through 2015 to comply with the Cap-and-Trade Program as owners and operators of gas compression stations, through their respective New Environmental Regulation Balancing Accounts (NERBAs).<sup>4</sup> SoCalGas and SDG&E are also authorized to record costs incurred to comply with the Cap-and-Trade Program as gas suppliers in their respective NERBAs through 2015, and proposed to recover actual costs incurred through an advice letter process. PG&E \_\_\_\_\_. Southwest Gas \_\_\_\_\_.

Prospectively, natural gas corporations should be authorized to track and record costs incurred to comply with the Cap-and-Trade Program, both as natural gas suppliers and as owners and operators of gas compressor stations, through a separate two-way Cap-and-Trade balancing account approved in this proceeding. Each utility would recover on a forecast basis through separate filings in June and updated in October of each year, its annual GHG compliance costs for the following year as a natural gas supplier through a specific GHG rate component, and for company facility GHG costs, as necessary, through base rates, subject to annual true-up and subject to the existing right of ORA and other parties to challenge any costs that are inconsistent with a utility's procurement authority. This is consistent with the proposed settlement filed on July 25, 2014.

Joint Parties propose to implement a GHG Surcharge to recover the costs incurred to comply with the Cap-and-Trade Program. This will likely require the utilities to either amend an existing tariff or file a new tariff to implement the surcharge. Costs should be allocated to all customers for whom the natural gas utility incurs the Cap-and-Trade costs.

To avoid a potentially large under-collection that could lead to a large rate increase, the Commission should not delay the recovery of Cap-and-Trade-related costs beyond January 2015. If necessary implementation details for the return of allowance

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<sup>4</sup> The NERBA is effective for the four-year General Rate Case cycle ending on December 31, 2015 or until the effective implementation date of SoCalGas and SDG&E's next General Rate Case.



auction revenues cannot be resolved in time for a January 1, 2015 implementation date, the Commission should issue a decision authorizing the utilities to recover their forecasted Cap-and-Trade costs for 2015, regardless of whether all of the revenue return implementation details have been put into place. This approach will protect customers from having to pay off a potentially large accumulated backlog at the same time that they begin paying current costs, and provide a more accurate price signal.

For the initial year 2015, Table 1 below summarizes the forecasted GHG compliance costs, and the associated revenue requirements, that the utilities should be authorized to use for purposes of recovering their 2015 forecasted costs in rates. Actual costs may differ from the forecasted amounts due to the difference between the proxy compliance instrument price and forecasted procurement need, and actual compliance instrument prices and actual net compliance obligations. Any such differences would be trued up the following year through the proposed balancing account and advice letter processes.

**Table 1<sup>5</sup>**

<b>Utility</b>	<b>End-User Revenue Requirement (\$000, inc. FF&amp;U)</b>	<b>Utility Facilities Revenue Requirement (\$000, inc. FF&amp;U)</b>
SoCal Gas	\$74,313	\$2,692
SDG&E	\$13,130	\$ 378
PG&E	\$63,460	\$3,230
Southwest Gas	\$2,594	

**C. Forecasting**

The scoping memo sets forth two issues to be addressed with respect to the forecasting methodology to be utilized by regulated natural gas utilities: (1) What

<sup>5</sup> The forecasted revenue requirements assume 25% of allowances are consigned to the ARB auction. The forecasted revenue requirements do not include administrative costs but administrative costs will be recorded and recovered in the new balancing accounts.

methodology, and what procedural mechanism, should the natural gas corporations use to forecast annual Cap-and-Trade-related costs and potential allowance revenues?; and (2) Can the natural gas corporations rely on public, nonconfidential data to report forecasts publicly without violating ARB confidentiality rules that prevent disclosure of market sensitive information? SoCalGas and SDG&E address these two issues as follows.

The Commission should authorize the natural gas utilities to submit annual Cap-and-Trade-related cost and revenue forecast advice letters using publicly-available forward prices. Natural gas utilities should forecast the GHG emissions for their customers that do not participate in the Cap-and-Trade Program directly and then subtract the number of allocated allowances forecasted to be used for direct compliance. This net remaining obligation should then be multiplied by the forward price, resulting in the forecast Cap-and-Trade direct compliance cost. The amount of revenue return to customer classes should be based on ARB regulations requiring an amount be consigned to the auction<sup>6</sup> and decisions in this proceeding. Any over- or under-collections should be trued-up through the next annual advice letter submission.

Based on a February 19, 2014 ARB note,<sup>7</sup> it appears that natural gas utilities may submit public (also referred to as “proxy”) forecasts for consideration by the Commission and interested parties without violating ARB confidentiality rules. Use of emissions based on historical emissions should similarly be public.

#### **D. Other**

The scoping memo sets forth four additional miscellaneous issues to be addressed in Phase 1. Joint Parties address the first three issues below. Joint Parties lack sufficient knowledge of the underlying implications of the fourth issue, and do not express an opinion with respect to the fourth issue.

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<sup>6</sup> See Proposed Cap-and Trade Regulation § 95893 (March 21, 2014).

<sup>7</sup> See March 10, 2014, Administrative Law Judge’s Ruling Supplementing the Record in A.13-08-002, et al.

1. *Natural gas corporations may have end-use customers that are large emitters due to their on-site combustion of natural gas or other fuels and that ARB regulates as covered entities. What steps should the corporations and the Commission take to ensure that these customers are not double-regulated for their GHG emissions?*

ARB will provide the natural gas utilities with a list of customers currently in the Cap-and-Trade Program, those who enter as a result of emissions exceeding the limit in the prior year and those opting in to the Cap-and-Trade Program, and those opting out. The utilities would only apply their proposed GHG Surcharges to the bills of customers who do not participate in the Cap-and-Trade Program directly and would not apply the surcharges to the bills of customers who participate in the Cap-and-Trade Program directly.

2. *Should each natural gas corporation annually publish the Cap-and-Trade-related costs that may be present in natural gas rates, and can natural gas corporations publish such costs without violating ARB confidentiality rules regarding disclosure of market sensitive information?*

The utilities would publish their respective GHG Surcharge rates annually. This information can be provided to customers without violating ARB confidentiality rules because the publication of the GHG Surcharge rate will not disclose auction participation (past, present or future), auction bidding strategy, bid price, bid quantity or bid guarantee information. In addition, the forecast of GHG costs will not be based on actual compliance instruments acquired, but on customers' emissions, so the rate impact will not reveal the utility's market position.

3. *What competitive neutrality issues should be considered to ensure that potential Cap-and-Trade related costs and revenues are implemented in a manner that treats CPUC-regulated gas distribution utilities and non-regulated gas suppliers fairly?*

The Commission should consider the competitive neutrality implications of the regulations adopted in this Rulemaking. To treat unregulated and regulated suppliers fairly, the Commission should avoid imposing undue restrictions on the ability of regulated utilities to participate in the Cap-and-Trade market.

4. *Should the Commission exempt independent gas storage providers from the obligation to participate as a respondent in this rulemaking?*

No comment.

### **III. CONCLUSION**

As proposed above and in the proposed settlement filed on July 25, 2014, Phase 1 issues should be resolved in a manner that supports statewide Cap-and-Trade objectives, is administratively efficient, and in the best interest of our customers. Specifically, the Commission should adopt procurement rules for regulated utilities that allow flexibility to transact in the Cap-and-Trade market for the benefit of our customers, establish two-way balancing accounts for the recording of direct costs, as well as related administrative and customer outreach costs of complying with Cap-and-Trade regulations, and adopt a forecasting methodology that relies on public data so that utility forecasts can be transparent and shared with all interested parties.

Respectfully submitted,

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