Decision 97-08-055 August 1, 1997

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY (U 39 G) for an Order Pursuant to Section 1005.5(b) of the Public Utilities Code to Increase the Maximum Cost Specified in PG&E's Certificate of Public Convenience and Necessity to Construct the California Portion of the Expansion of its Natural Gas Pipeline.	Application 92-12-043 (Filed December 21, 1992)
And Related Matters.	Application 93-03-038 Application 94-05-035 Application 94-06-034 Application 94-09-056 Application 94-06-044 Application 96-08-043 Rulemaking 90-02-008 Rulemaking 88-08-018 Rulemaking 92-12-016 Investigation 92-12-017 Application 92-07-049 Application 95-02-008 Application 95-02-010 Application 94-11-015 Application 93-04-011 Application 94-04-002 Application 95-04-002 Application 96-04-001 Application 94-12-039

(See Decision (D.) 93-10-069, D.94-12-061, and D.96-09-095
for appearances; see Appendix A for additional appearances.)

SIXTH INTERIM OPINION

1. Summary of Decision

A comprehensive settlement known as the Gas Accord is approved as clarified. The Gas Accord resolves issues in five phases of the first general rate case for Line 401, the California segment of a pipeline expansion project owned and operated by Pacific Gas and Electric Company (PG&E). The five phases cover: (1) market issues, including terms and conditions of service on Line 401; (2) amortization of costs recorded in PG&E's interstate transition cost surcharge (ITCS) balancing account; (3) a reopening of PG&E's decision to construct the pipeline expansion; (4) two competing settlements, the Gas Accord and a separate Joint Recommendation; and (5) Line 401 capital costs and operations and maintenance expenses.

While the Commission is approving the Gas Accord, the Commission nevertheless finds that PG&E holds market power in California, that PG&E has a present conflict of interest in marketing Line 401 capacity on behalf of shareholders and brokering unused Southwest capacity on behalf of ratepayers, that under the Gas Accord PG&E will have a conflict of interest in marketing Line 400/401 capacity on behalf of shareholders and against discounting Line 300 capacity on behalf of noncore customers, and that PG&E may have conflicts of interest in its procurement of gas for its core customers. Rather than reject the Gas Accord, the Commission will impose a discounting rule in its order approving the Gas Accord. This rule is necessary to mitigate PG&E's conflict of interest and to enable fair competition between Canadian, California, and Southwest supply sources. The Commission can further address PG&E's continuing conflicts of interest in other proceedings.

The Commission leaves undisturbed previous findings that PG&E's October 25, 1991, decision to construct Line 401 was reasonable. While the Commission will not allow private parties in the Gas Accord to settle alleged Rule 1 violations concerning PG&E's testimony about its decision to construct Line 401, the Commission finds that a separate settlement of the alleged Rule 1 violations negotiated by the Commission's Consumer Services Division and PG&E is in the public interest.

The Joint Recommendation is rejected because it would hinder progress toward unbundled rates, and the Gas Accord with a discounting rule reaches a more desirable outcome.

2. Background

This consolidated proceeding is the first general rate case for PG&E's Line 401, the California segment of a natural gas pipeline expansion project that extends from Alberta, Canada to Kern River Station in Southern California. The Commission granted a Certificate of Public Convenience and Necessity for the California segment in Decision (D.) 90-12-119, issued December 27, 1990, which was predicated upon incremental pricing.[1] The pipeline went into service on November 1, 1993. Line 401 has a design firm delivery capacity of 755 million cubic feet per day (MMcf/d), and an average annual firm capacity of 851 MMcf/d. Prior opinions describe the mechanical features of Line 401 and historical and procedural background through early August 1996.[2]

The Commission has issued nine decisions in this proceeding, and three related resolutions. Four actions stand out: (1) D.93-10-069 authorized temporary interim rates and terms and conditions of service, effective when Line 401 went into commercial operation; (2) D.94-02-042 increased a previously ordered cost cap, set interim rates, and found PG&E's decision to construct Line 401 to be reasonable; (3) D.94-12-061 ordered a scheme of receipt point capacity allocation (RPCA) at the California-Oregon border, and authorized direct connections to Line 401 in limited circumstances; and (4) D.96-09-095 terminated a backbone credit mechanism intended to relieve Line 401 shippers from certain duplicative charges. Several petitions for modification of those decisions are outstanding, but we do not address the petitions in this decision.

Parties litigated the reasonableness of PG&E's decision to construct Line 401 in an earlier phase of this proceeding, and adopted a finding of reasonableness in D.94-02-042.[3] On June 27, 1995, administrative law judge (ALJ) James Weil reopened the decision to construct in order to

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[1] 39 CPUC2d 69, 166 (1990).
[2] D.94-02-042, Third Interim Opinion, 53 CPUC2d 215, 222-223 and Appendix A at 254 (1994); D.96-09-095, Fifth Interim Opinion, at mimeo. pp. 2-6 (1996).
[3] D.94-02-042, Finding of Fact 11, 53 CPUC2d 215, 248 (1994).

review new evidence. Norcen Energy Resources Limited (Norcen) and other parties claim that PG&E violated Rule 1 of the Commission's Rules of Practice and Procedure by concealing critical documents. The reopening began with the revelation--in another proceeding--of an October 24, 1991, memorandum from PG&E Vice President Jerry R. McLeod to several PG&E managers and attorneys (McLeod memo).[4] The memo is a 42-page document, including a cover memo, an eight-page presentation prepared for an October 25, 1991, meeting of the PG&E steering committee that would make the decision to go forward with the expansion project, and several attachments. The most significant attachment is an economic study by McKinsey & Company, a management consulting firm. The principals in the dispute over the decision to construct are PG&E versus Norcen, Toward Utility Rate Normalization (TURN),[5] and El Paso Natural Gas Company (El Paso). Other parties presented arguments in briefs.

The first seven applications listed in the caption for this decision, beginning with Application (A.) 92-12-043 and ending with A.96-08-043, comprise the Line 401 general rate case and are consolidated without restriction. Before August 1996 there were four active phases in the proceeding: (1) a market issues phase, including many general rate case issues; (2) an ITCS phase, by consolidation with A.94-06-044, in which PG&E seeks to amortize in rates the charges recorded in its ITCS balancing account; (3) a reopening of PG&E's decision to construct the pipeline expansion; and (4) a Pipeline Expansion Project Reasonableness (PEPR) phase, covering capital costs and incremental operating and maintenance expenses.

On August 21, 1996, PG&E filed concurrently A.96-08-043 and a motion in this and other proceedings, which together seek Commission approval of a broad settlement known as the Gas Accord. In a ruling issued October 18, 1996, the ALJ consolidated the proceedings covered by the motion solely for purposes of considering the Gas Accord. On September 24, 1996, three parties filed a motion for Commission approval of a Joint Recommendation intended to supplant many provisions of the Gas Accord. Together, the Gas Accord and the Joint Recommendation are

[4] Exhibit 455 in this proceeding, Exhibit 263 in A.93-04-011.
[5] Effective November 13, 1996, Toward Utility Rate Normalization changed its name to The Utility Reform Network. The acronym TURN is unchanged.

the subjects of a fifth active phase of the consolidated proceeding. This decision will address all five active phases.

Market issues are the subject of market assessment reports prepared by several parties, a market assessment workshop, post-workshop comments, prepared testimony, hearings, and briefs. ITCS issues are also fully developed in prepared testimony, hearings, and briefs. The combined record on market and ITCS issues includes 163 exhibits, transcripts of 35 days of hearings, and opening and reply briefs.[6] The record on the decision to construct includes 161 exhibits, transcripts for eight days of hearings, portions of the same opening and reply briefs, and supplemental briefs.[7]

No formal hearings were held regarding the Gas Accord and the Joint Recommendation. Instead, we rely on pleadings, questions and answers filed following two workshops, and filed comments. The record on the Gas Accord begins with A.96-08-043 and five PG&E documents associated with the application.[8] The ALJ led unreported workshops on September 11-12 and November 5, 1996. The first workshop was generally dedicated to details of the Gas Accord. The second workshop covered: (1) a supplemental report on a post-1997 Core Procurement Incentive Mechanism (CPIM) , an element of the Gas Accord that was incomplete when the Gas Accord was filed; (2) the Joint Recommendation; and (3) remaining Gas Accord topics. The central purposes of the workshops were to develop questions and clarify uncertainties about the Gas

[6] Exhibits 201 through 362, and Exhibit 561, a comparison exhibit; Transcript Volumes 34 through 68, taken at hearings beginning April 1 and ending June 5, 1996; opening and closing briefs, filed June 26 and August 9, 1996.

[7] Exhibits 401 through 560, and 562; Transcript Volumes 69 through 76, taken at hearings beginning June 10 and ending June 20, 1996; opening and closing briefs, filed June 26 and August 9, 1996; and supplemental briefs, filed October 26, 1996.

[8] The documents are: (1) PG&E's "Report on the Gas Accord Settlement," which has the character of prepared testimony; (2) Appendix 1, which is the Gas Accord itself; (3) a two-page document containing revised Tables 15 and 18 in Appendix 1, distributed by PG&E on September 11, 1996; (4) Appendices 2 and 3 to the report, containing recommendations by two customer advisory groups; and (5) a compendium of Gas Accord work papers.

Accord and the Joint Recommendation. The parties answered the questions and discussed contested issues in subsequent written comments. Workshop discussions are not part of the record.

Formal record documents related to the Gas Accord include: (1) PG&E's August 21, 1996, motion to adopt the Gas Accord; (2) filed responses to the August 21 motion; (3) PG&E's October 18, 1996, motion to supplement A.96-08-043 with a post-1997 CPIM report, and the attached report; (4) four rounds of comments following the two workshops, filed September 24, October 4, November 14, and November 21, 1996; (5) a PG&E addendum to its November 14 comments, filed the next day; (6) PG&E supplemental comments filed on November 22, 1996, with the permission of the ALJ; (7) copies of side deals with four Line 401 shippers, and Gas Accord agreements executed by PG&E and three of the four shippers, attached to PG&E procedural comments filed December 5, 1996; (8) a copy of a Gas Accord agreement executed by the fourth shipper, attached to supplemental procedural comments filed by PG&E on December 9, 1996; and (9) two rounds of comments on the side deals, filed December 20 and December 30, 1996.

The record on the Gas Accord does not include draft implementation tariffs distributed by PG&E, or any written information relating to informal tariff workshops held by PG&E beginning in November 1996. Parties may raise concerns about tariffs when tariff revisions are filed for Commission approval.

The record on the Joint Recommendation includes the September 24, 1996, motion for adoption; filed responses to the motion; questions and answers contained in post-workshop comments filed on November 14, 1996; and discussion embedded in reply comments filed November 21, 1996.

Although the parties have served prepared testimony in the PEPR phase, hearings have not been convened. The Gas Accord would settle most PEPR issues.

Many parties actively participated in developing the record supporting this decision. Seventeen parties signed the Gas Accord before it was filed: (1) Amoco Canada Marketing Company, Amoco Energy Trading Corporation, and Amoco Production Company (together, Amoco); (2) California Cogeneration Council (CCC); (3) California Independent Producers Association (CIPA); (4) California Industrial Group (CIG); (5) California League of Food

Processors (CLFP); (6) California Manufacturers Association (CMA); (7) City of Palo Alto (Palo Alto); (8) CNG Power Services Corporation; (9) Division of Ratepayer Advocates (DRA);[9] (10) Enron Capital & Trade Resources; (11) Enserch Energy Services (Enserch); (12) International Brotherhood of Electrical Workers; (13) PG&E; (14) School Project for Utility Rate Reduction and Regional Energy Management Coalition; (15) Sacramento Municipal Utility District (SMUD); (16) Suncor, Inc.; and (17) Transwestern Pipeline Company (Transwestern). Two parties wrote letters of support to PG&E, but did not execute Gas Accord agreements prior to PG&E's filing of A.96-08-043: U.S. Defense Logistics Agency, Defense Fuel Supply Center; and Northern California Power Agency (NCPA). In its September 24, 1996, post-workshop comments, Southern California Edison Company (Edison) announced its intent to sign the Gas Accord, but did not include an executed agreement. Formal support for the Gas Accord by Edison and four other shippers was revealed in attachments to PG&E's December 5 and December 9, 1996, comments. The four other shippers are San Diego Gas & Electric Company (SDG&E), NCPA, Rigel Oil & Gas Ltd., and Ulster Petroleums Ltd.

Three parties sponsor the Joint Recommendation: Department of General Services of the State of California (DGS); Department of Energy, Minerals & Natural Resources and the State Land Office of the State of New Mexico (together, New Mexico); and TURN.

Several other parties actively participated in hearings and workshops: (1) Alenco Gas Services, Inc.; (2) DEK Energy Company and Apache Canada Ltd. (together, Apache); (3) Burlington Resources; (4) Canadian Association of Petroleum Producers (CAPP); (5) CanWest Gas Supply U.S.A., Inc. (CanWest); (6) Chevron U.S.A. Inc. (Chevron); (7) El Paso; (8) Foster Associates; (9) Independent Energy Producers Association; (10) Interstate Gas Services, Inc.; (11) Mock Energy Services, L.P.; (12) Natural Gas Clearinghouse, Inc.;

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[9] Effective September 10, 1996, the Executive Director abolished the DRA as an organizational unit at the Commission. Former DRA professional staff working on this proceeding are redeployed to a new Office of Ratepayer Advocates (ORA). Because the Gas Accord and initial related pleadings were filed prior to abolishment, this decision recognizes both DRA and ORA as the Commission's advocacy staff.

(13) Norcen; (14) North American Chemical Company; (15) Pacific Gas Transmission Company (PGT), the PG&E subsidiary that owns and operates the segment of the pipeline expansion from the Canadian border to the California-Oregon border; (16) PanCanadian Petroleum, Ltd.; (17) Southern California Gas Company (SoCalGas); (18) Southern California Utility Power Pool and Imperial Irrigation District, acting principally on behalf of three Line 401 firm shippers, which are the Cities of Burbank, Glendale, and Pasadena; and (19) Wild Goose Gas Storage Company (Wild Goose).

The record supporting this opinion was submitted for Commission decision on December 31, 1996, by ALJ ruling following receipt of reply comments on side deals associated with the Gas Accord.

3. Market Assessment

PG&E originally intended that Line 401 would transport Canadian gas only to Southern California. When Southern California demand did not fill the pipeline, PG&E looked to Northern California markets. Today Line 401 offers gas transportation service from the California-Oregon border at Malin, Oregon, to Southern California at Kern River Station, the southern terminus, and to Northern California at intermediate points. Coupled with downstream pipeline systems operated by PG&E, SoCalGas, and SDG&E, Line 401 can serve end users in most of California.

The connecting distribution systems operate largely without constraints or bottlenecks. The same is not true for transmission-level alternatives to Line 401. PG&E's Line 400 parallels Line 401 from Malin to the Antioch terminal. Line 400 has lower embedded costs and lower rates than Line 401. Demand for Line 400 service, driven by Canadian gas supply prices that are lower than competing Southwest U.S. supply prices, almost always exceeds the capacity of Line 400. Correspondingly, interstate pipelines that deliver gas from the Southwest into California now operate at low capacity factors. With Line 400 generally operating full, Line 401 competes directly with Southwest interstate pipelines. California gas supplies do not have the capacity to alter the basic features of this competition.

Marketers now dominate gas sales to noncore end users in PG&E's service territory. End users are generally concerned with burnertip prices, not gas supply basins or transportation routes. Among noncore customers, only PG&E's utility electric generation (UEG) department and a few large end users actively purchase gas at supply basins, then arrange for transportation service.

Demand in excess of capacity on Line 400 has led to market responses that vex market participants. In D.94-12-061, issued December 21, 1994, the Commission ordered an RPCA scheme at Malin that allocates to noncore shippers the available pipeline capacity on Lines 400 and 401. The adopted scheme is based on end-use priorities, and continues a “crossover ban” previously ordered by the Commission as an essential element of incremental ratemaking for the new pipeline. Under the crossover ban, quantities of gas transported anywhere on the PGT portion of the expansion project are subject to incremental Line 401 rates in California. Marketers have responded to RPCA rules and the crossover ban by transferring ownership of gas packages upstream from Malin, by direct sales or exchange agreements, and by overnominating daily deliveries into Line 400. There is no consensus among the parties or among pipeline customers on how to resolve RPCA problems.

In its market assessment report, PG&E concludes that regional gas markets are competitive and are becoming increasingly integrated.[10] According to PG&E, an economic link exists between Canadian and Southwest supply basins, despite their geographic separation. Price changes in Canada or the Southwest are transmitted to the other region through competitive interactions in California, which is the contested consuming market.

Other parties discuss more specific market features in their market assessment reports, which are attached to September 20, 1995, post-workshop comments. Amoco, PGT, and Wild Goose recite problems with the crossover ban, the existing RPCA scheme, overnominations at Malin, and peculiar market rules. CanWest reminds the Commission that gas supplies are developed in British Columbia as well as Alberta, Canada. CIPA notes that PG&E still holds a monopoly on most intrastate transportation service within its service territory. El Paso believes that PG&E has a conflict of interest in operation of Line 401, and that ratepayers are harmed by the crossover ban. PG&E and Edison claim that Canadian competition has lowered overall gas prices in California, despite market problems.

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[10] Exhibit 207, Chapter 3C.

PG&E sets prices for as-available service on Line 401 based on competitive alternatives at Topock, Arizona, the principal receipt point for Southwest gas that enters California. In review of the Gas Accord and other issues in this proceeding, we should examine PG&E's market power, now and under the Gas Accord and other future ratemaking scenarios. We define market power as the ability to sustain revenues, through increased prices or sales, above competitive levels for a significant period of time.

3.1 Measures of Market Behavior

There is much information in the record about PG&E's market behavior, but we will endorse no single measure of market power. Instead, we begin by looking at five characteristics of PG&E's participation in gas transportation markets: (1) sufficiency of supply and transportation alternatives, (2) assured sales, (3) the Herfindahl-Hirschman Index (HHI), (4) mitigation and regulation effects, and (5) geographic constraints. PG&E asserts that it has little market power because it cannot sustain control over gas prices at Topock. Whether that single statement is true or not, we must take a broader view of possible market power. PG&E holds virtual monopoly power over intrastate transportation in Northern California.

PG&E claims that it acts as a price follower when it sets Line 401 rates because PG&E has no ability to control market prices. According to PG&E, SoCalGas is the price leader at Topock. PG&E recites several supply alternatives for noncore end users: Southwest gas transported on the El Paso, Kern River Gas Transmission Company, and Transwestern pipelines; California gas; and gas withdrawn from storage. However, PG&E sets Line 401 prices based on only one of those alternatives--El Paso deliveries to Topock. This competition between only two supply sources suggests that PG&E might have significant market power.

On the other hand, the capacity of Line 401 is less than the difference between total interstate capacity into California and typical total demand. There is sufficient overall pipeline capacity that PG&E is assured of only limited sales of Line 401 capacity. By itself, this factor indicates that PG&E might not have significant market power.

The HHI is a measure of market concentration frequently used to assess competitive effects of mergers and acquisitions. The index does not predict anti-competitive behavior by a firm, but is a measure of the number of active participants in a market. For example, the HHI for interstate transportation of Southwest gas into California during 1995 was approximately 0.44, indicating 2.3 effective competitors in that limited market.[11] Looking only at this measure, we would conclude that SoCalGas and PG&E are dominant players at Topock.[12]

Market power can be mitigated by regulation, but individual circumstances must be reviewed carefully. Regulation now has little impact on price competition between Line 401 and PG&E's Line 300, which delivers gas from Topock to PG&E's service territory. The lower limit for Line 401 prices is the cost of original system backbone facilities plus $0.02 per decatherm (Dth).[13] This leaves PG&E much latitude for discounting below the tariff rate of approximately $0.48/Dth. Service on Line 300 is sold at tariff rates; delivered gas costs are determined by upstream costs of Southwest gas and interstate pipeline service to the border. Incremental interstate service is typically over the El Paso pipeline using capacity that is under contract to PG&E but is not used by PG&E customers. PG&E sells that excess capacity under its capacity brokering program. PG&E sets minimum bids for brokered capacity, but claims that actual prices are often negotiated downward to rates lower than the posted minimums. Commission regulation includes reasonableness review of the negotiated transactions, as part of this proceeding, but such retrospective review has little effect on PG&E's market power. Taken as a whole, there seems to be little regulatory mitigation of PG&E's potential market power at Topock.

In times when gas markets were isolated and regional, geographic constraints enhanced utility market power. Today we share PG&E's expectation that national gas markets will become increasingly integrated. Nonetheless, geographical factors have led to the emergence of Malin and Topock as the two principal entry points for transportation of gas into California. To a certain extent, geography has caused the present constraint on Line 400. We cannot simply find that increasing market integration prevents PG&E from exercising market power.

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[11] Recorded 1995 data taken from the "1996 California Gas Report," p. 19. At the border, SoCalGas transported 63.5%, PG&E transported 14.5%, and nonutilities transported 21.6% of Southwest gas delivered to California. The calculated HHI assumes four or five nonutilities, and includes Mojave pipeline gas. The number of effective competitors is the inverse of the HHI.

[12] Issues relating to market power for SoCalGas will be examined more closely in A.96-10-038, the merger application of Pacific Enterprises and Enova.

[13] D.94-02-042, 53 CPUC2d 215, 239 (1994).

3.2 PG&E Market Power

We draw no firm conclusions about PG&E's market power from the above simple measures of market behavior. We must dig deeper. In doing so, we should keep in mind the relationships among gas supply, transportation, and distribution costs. Currently, procurement costs are roughly $2.20/Dth, and local transmission and distribution costs are in the range of $0.75/Dth for noncore customers to $2.65/Dth for core customers, exclusive of public purpose and balancing account charges. By comparison, Line 401 firm service tariff rates are approximately $0.48/Dth, and as-available service is discounted below that. Interstate pipeline costs for Southwest gas are scarcely above variable costs, in the neighborhood of $0.10/Dth. The transportation rates disputed in this proceeding are important, but they are only a small fraction of burnertip gas costs. Therefore, the effects of gas transportation ratemaking on supply competition and California's pipeline infrastructure are crucial to our deliberations.

PG&E and El Paso provide the best evidence on utility market power. PG&E makes many arguments about competition and pipeline markets, but they can be reduced to six principles. First, according to PG&E, markets are workably competitive if actual prices are substantially the same as prices that would result from full competition. No single party holds the power to control prices in the market. Second, PG&E cannot control prices or flows of gas at the California border, specifically at Topock or Malin. Third, theoretically, the existence of two market participants produces competition because one party can undercut prices that are set artificially high by the other party. In this way PG&E and SoCalGas compete against each other for sale of brokered interstate capacity into Topock. Fourth, gas supply competition in Alberta and burnertip competition in the end use market in California eliminate the possibility of market power in the transportation corridor between the two locations. Fifth, increased supply costs in Alberta caused by increased gas demand in California--enabled by construction of the expansion project by PG&E and PGT--are mitigated by consequent increased drilling and production in the supply basin. Sixth, overall gas cost reductions achieved in California subsume customer costs for new pipeline capacity. PG&E claims that California gas costs have dropped by $1.3 billion in the two years since Line 401 has gone into service, and costs in PG&E's service territory have dropped by more than $500 million.

El Paso concludes that PG&E does have market power at Topock. El Paso believes the gas transportation market there fits the “dominant firm/competitive fringe” model. One or several firms are dominant price setters in the market, and other, smaller players operate within the fringe of the price-setting behavior of the dominant firms. In this case, SoCalGas and PG&E are the dominant firms. According to El Paso, these circumstances inevitably lead PG&E to use its market power in setting Line 401 prices. The effectiveness of PG&E’s pricing strategy confirms that PG&E holds market power. El Paso believes that PG&E’s minimum bids for brokered capacity held on the El Paso pipeline allow PG&E to control Topock prices and thereby control market rates for Line 401 capacity. El Paso criticizes PG&E’s calculation of gas cost savings since Line 401 went into service, claiming that the observed cost reductions are due to factors like lower Canadian and San Juan basin supply prices and lower upstream pipeline costs. Most of PG&E’s calculated cost savings began at least one year after Line 401 went into service. El Paso believes that PG&E’s expansion project has caused at least $289 million in excess pipeline demand charges.

We will not make a finding of fact that the transportation market at Topock follows the dominant firm/competitive fringe model strictly, but in our judgment that model is the best description of market dynamics there. PG&E’s theoretical model of two-party competition is too limited. SoCalGas and PG&E control dominant shares of incoming interstate capacity, at least until their various contracts with interstate pipelines expire. Several factors give the utilities incentives to exercise price leadership at Topock. The market is concentrated, interstate pipeline capacity is in part substitutable, pipeline cost functions are similar, there are barriers to market entry, and overall demand for capacity is relatively inelastic. Price leadership is not necessarily collusive, but it gives SoCalGas and PG&E the opportunity to coordinate their behavior in ways that can lead to higher than competitive prices.

We do not endorse PG&E’s theory that supply basin competition and burnertip competition are sufficient to preclude market power in the transportation corridor between Canada and California. Because there are few supply alternatives to Canadian gas, and transportation costs are not large relative to fundamental supply price differences between Canada and the Southwest, PG&E may hold enough market power to limit end user access to the supply price benefits of Canadian gas.

Considering all the evidence before us, we find that PG&E does hold market power at Topock and within California. PG&E may not be able to control gas prices at Topock, but to a substantial degree it can control flows through Topock and can sustain flows and therefore revenues on Line 401.

4. Conflict of Interest

Several parties, led by TURN and El Paso, claim that PG&E has a conflict of interest in the operation of its gas system. TURN believes the conflict between shareholders and original system ratepayers arises from the Commission's "let the market decide" policy, under which Line 401 was certificated. PG&E concedes that Line 401 competes against brokered Southwest pipeline capacity. TURN points out that when Line 401 wins that competition, shareholders retain the revenues. When brokered capacity wins, revenues accrue to ratepayers as credits to PG&E's ITCS account. Because PG&E is responsible for marketing both of the competing products, it has a conflict of interest. TURN asserts that while PG&E would be expected to deny that it ever benefited from the conflict of interest, to deny its existence is simply not credible.

El Paso concurs, and claims that the conflict pervades PG&E's operations. El Paso cites several examples: pursuit of subsidies for Line 401 through roll-in of the Line 401 revenue requirement with original system rates, setting of inflated minimum bids for brokered Southwest capacity, more extensive marketing efforts for Line 401 than for brokered capacity, PGT interruptible service discounting policies, backbone credit practices, inadequate consideration of gas supply diversity, and others. El Paso characterizes PG&E's decision to terminate service over the El Paso pipeline when current service agreements expire as the ultimate manifestation of the conflict of interest. El Paso believes the conflict of interest has led to stranded costs of $101 million through May 1995.

PG&E argues that it has no conflict of interest in marketing its various holdings of pipeline capacity. According to PG&E, the term "conflict of interest" is no more than an inflammatory slogan unless it is coupled with the power to exploit the conflict, and marketplace competition prevents PG&E from doing so. PG&E claims that it has set up a competitive environment without creating incentives that favor Line 401 or El Paso capacity, and that it does not have the market power to take advantage of any perceived conflicts. Elements of PG&E's plan include arm's length operations by PGT, organizational separation of UEG and core procurement functions, and management vigilance against conflicts of interest.

The Public Utilities Code neither defines conflict of interest nor prohibits conflicts of interest within utility management. Direct regulation of utility monopolies is in large part meant to control or neutralize conflicts of interest between shareholders and ratepayers. Faced with increased competition in utility industries, it remains our duty to authorize regulatory schemes which minimize such conflicts. Our goal in this proceeding is to provide PG&E with incentives to exercise its discretionary management functions in an evenhanded manner, so that ratepayers receive fair treatment as PG&E executes its fiduciary duties on behalf of shareholders. In the context of this proceeding, a conflict of interest arises when PG&E has a duty on behalf of shareholders to contend for outcomes which its duty to ratepayers requires PG&E to oppose. We do not presume that PG&E will represent ratepayers if that representation will be directly adverse to shareholder interests. In our view, such a conflict exists whenever there is a reasonable possibility that the utility will not exercise its discretion fairly. We need not determine whether a conflict is actual, in the sense that preference or harm is supported by direct evidence, or only gives an appearance of conflict.

We concur with TURN and in part with El Paso in this dispute. Shareholders benefit when Line 401 serves market demand, and ratepayers benefit when brokered capacity serves the demand. By PG&E's own admission, the two services compete for the same loads. There is a reasonable possibility that PG&E acts preferentially in favor of shareholders when it markets the two services. Therefore, PG&E has a conflict of interest.

It is more difficult to determine whether actual harm has ensued, as El Paso claims. In some circumstances, PG&E has clearly responded to the conflict of interest in favor of shareholders: through pursuit of rolled-in rates, by pricing Line 401 service to compete with brokered capacity, and by Line 401 marketing efforts that are more vigorous than capacity brokering efforts. PG&E's actions have been successful. In 1994, Line 401 operated at approximately 71% of its design capacity, or approximately 51% of as-available capacity after subtraction of firm service quantities. By comparison, in 1994 PG&E sold approximately 53% of unused El Paso capacity under its capacity brokering program. Monthly charges to the ITCS memorandum account rose from 1994 to 1995, and PG&E predicts that sales of brokered El Paso capacity will decline. At the same time, more than 90% of Northern California deliveries over Line 401 were found to be eligible for the backbone credit, thereby increasing revenues to PG&E shareholders. El Paso's vehement reaction to loss of PG&E as a pipeline customer is understandable, but we cannot agree with El Paso that termination of service to PG&E is the ultimate manifestation of the conflict of interest.

We will consider the consequences of PG&E's future conflicts of interest in review of the Gas Accord.

5. Gas Accord

The full Gas Accord document is 87 pages long; it is reproduced in Appendix B to this decision. As required by Rule 51.1(e) of the Commission's Rules of Practice and Procedure, we can approve the settlement only if it is reasonable in light of the whole record, consistent with law, and in the public interest. We must make an independent determination on these issues rather than simply deferring to the number of parties supporting the settlement.

5.1 Elements of the Gas Accord

In a nutshell, the Gas Accord would: (1) unbundle gas transportation service into specific paths, with assignment of capacity to core customers, and partial roll-in of Line 401 costs into Line 400 rates; (2) offer various service options to existing Line 401 firm service customers; (3) include core procurement costs in rates based on two CPIM proposals; (4) settle contested issues regarding ITCS amortization, Line 401 capital costs, and recent gas reasonableness reviews, including PG&E's federal district court challenge to one of our reasonableness reviews; and (5) set transmission , and storage rates for the Gas Accord period through December 31, 2002.

In the Gas Accord (p. 68), PG&E has specifically agreed that if the Gas Accord is approved without modifications or with modifications acceptable to PG&E and DRA, PG&E would "permanently forego recovering from its ratepayers any of the disallowance ordered by Decision 94-03-050, which has been (or will be) refunded to ratepayers, notwithstanding the outcome of its pending lawsuit in Federal District Court (Civil No. C-94-4381 WHO)."[14] On page 8 of PG&E's April 23, 1997 comments on the ALJ's proposed decision, PG&E also explicitly represented to the Commission that with the approval of the Gas Accord, PG&E would "forego appeals of other Commission decisions, such as the 1988-90 Gas Reasonableness Decision (Re Pacific Gas and Electric Co., D.94-03-050; 53 CPUC 2d 481 (1994)), presently on appeal to the Federal District Court (Civil No. 94-4381 SBA)."[15]

Presumably, DRA had made a concession to PG&E as a <u>quid</u> <u>pro</u> <u>quo</u> for PG&E's commitment to forego its federal court case. Accordingly, our approval of the Gas Accord is based upon PG&E's following through on all of its commitments, including PG&E foregoing its federal district court challenge as represented in PG&E's April 23, 1997 comments (at p. 8). We are therefore explicitly stating in our Ordering Paragraph that our approval of the Gas Accord is based, in part, upon PG&E's commitments to permanently forego recovering from its ratepayers any of the disallowance order by D.94-03-050 which has been (or will be) refunded and to forego its appeal of the D.94-03-050 to the Federal District Court (Civil No. 94-4381).

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[14] In ORA's October 4, 1996 reply comments on the Gas Accord settlement (p. 17), ORA explained that this provision "would assure that ratepayers would retain the $90 million (plus interest) disallowance ordered by the Commission…" A substantial amount of this disallowance resulted in a refund from PG&E to its own UEG and the Gas Accord states that this amount would be credited to PG&E's Energy Cost Adjustment Clause (ECAC) balancing account. In light of the passage of AB 1890, subsequent to the August 21, 1996 filing of the Gas Accord, the amounts in the ECAC balancing account would not inure to the benefit of the PG&E's ratepayers, as DRA had intended, unless the UEG's share of the disallowed amounts was refunded from a different account. However, we have already resolved this matter in D.96-12-025, D.96-12-026, and D.96-12-027 issued on December 9, 1996, where we held that disallowed amounts must be credited to an Electric Deferred Refund Account (EDRA), instead of PG&E's ECAC, and then refunded to PG&E's electric ratepayers. Our approval of the Gas Accord does not alter our rulings in D.96-12-025, D.96-12-026, and D.96-12-027, and, therefore, PG&E must adhere to our explicit ruling in D.96-12-026, which already required the UEG's share of the $90 million (plus interest) disallowed amounts to be returned to electric ratepayers through the EDRA, and to our general requirement in D.96-12-025 that any and all settled disallowed amounts must be returned to ratepayers through the EDRA rather than be credited to PG&E's ECAC.

[15] In PG&E's June 18, 1997 comments on the Proposed Alternate Order, PG&E incorrectly asserts that the Proposed Alternate Order <u>assumed</u> that under the Gas Accord, PG&E would "forego" its federal district court challenge. However, the Proposed Alternate Order did not state

Footnote continued on next page

Gas Accord service paths would begin at Malin, Topock, or California facilities. Delivery points, generally, would be labeled on-system (within the PG&E service territory) and off-system (outside the service territory). Core reservations would be approximately 600 MMcf/d on Line 400 and 150 to 600 MMcf/d on Line 300, the latter varying seasonally. There would be no crossover ban and no balancing account to guarantee PG&E revenues. Rates for noncore distribution service would be seasonally differentiated.

Current Line 401 firm shippers would face rates based on $736 million of Line 401 capital costs. Shippers could choose among three options: (1) Accord service, available if the shipper waives Universal Terms of Service (UTS) rights; (2) G-XF service, which is much like present service but with UTS rights limited to firm service; or (3) individually negotiated options, subject to Commission approval.

The first CPIM, applicable to the period from June 1, 1994, through December 31, 1997, incorporates a core procurement price formula agreed upon by PG&E and DRA in A.94-12-039, PG&E's current CPIM application. From January 1, 1998, through December 31, 2002, the formula would be modified to include daily sequencing in place of monthly price weightings, a Topock price index in place of Southwest basin prices, limited recovery of Transwestern pipeline demand charges, and other terms.

Several general rate case and gas reasonableness issues would be settled. Line 401 initial capital costs of $736 million would be included in Line 400/401 rolled-in rates and Line 401 incremental rates. PG&E would absorb 50% of outstanding noncore ITCS costs, 100% of core ITCS costs, the backbone credit account balance, and $3.7 million of contested 1988-1990 costs. PG&E would not be responsible for any "statewide ITCS" costs, which are essentially Southern California stranded costs caused by Line 401. Commission proceedings regarding PG&E's decision to construct and related Rule 1 allegations would be terminated.

Most core and noncore transportation rates would be reduced from current values, but would be subject to 2.5% annual escalation from 1998 through 2002. Utility intentions about ratemaking treatment of the side deal payment from Edison to PG&E are not in the record.

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this as an assumption; the Proposed Alternate Order referenced PG&E's April 23, 1997 comments for PG&E's explicit representation in this regard.

5.2 Features Supporting Approval

The Gas Accord has several attractive features. First, the settlement has the support of a broad spectrum of active parties. ORA is a government entity that represents the interests of all customers, and CIG, CMA, and CLFP represent noncore customers specifically. With the support of Edison and SDG&E, which came after the settlement was reached, a majority of current firm shippers on Line 401 have joined the Gas Accord. Other endorsements are the result of bilateral agreements, or side deals, between PG&E and individual parties. The side deals generally settle issues of reduced interest to other parties. For example, the sale of pipeline equity shares to SMUD is very important to SMUD itself, but is not of compelling interest to other parties.

Second, the Gas Accord would unbundle PG&E's gas transmission system into separate services. This would improve flexibility and customer choice among noncore service options, and would allow a closer match of transportation rates with facilities used to provide service. With unbundling comes a logical reliance on embedded costs in calculating rates. Direct comparison between marginal cost and embedded cost methods has not been the focus of this proceeding, but in general the matching of rates and facilities is enhanced by embedded cost ratemaking. Marginal costs (after adjustment for embedded cost revenue requirement) can be used to allocate utility costs fairly among customer classes, but resulting rates can be very sensitive to initial marginal cost decision choices. As service is unbundled into manageable components, cost allocation problems and the need for marginal cost allocation procedures are diminished. PG&E responsibility for the transmission revenue requirement is also a desirable element of the proposed unbundling scheme, with attendant elimination of balancing accounts. It would assist in protecting original system ratepayers from costs or risks associated with Line 401, as PG&E promised in the certification proceeding.

Third, the Gas Accord would resolve difficult issues in various Commission proceedings. There is no common yardstick for comparing administrative benefits against the risk that issues might be settled unfairly or inefficiently. That is why support from parties with diverse interests is important. Nonetheless, settlement of contested issues in arduous proceedings has value for the Commission and the parties. In the Line 401 general rate case, the Gas Accord would settle issues regarding capital costs, operations and maintenance expenses, receipt point capacity allocation, the crossover ban, ITCS amortization and past conflicts of interest, backbone credit balancing account amortization, core capacity reservation, and the decision to construct. In other proceedings, the Gas Accord would settle CPIM issues, gas reasonableness review disputes, and details of PG&E's core aggregation program. Along with resolution of contested issues comes the benefit of rate certainty during the Gas Accord period.

Fourth, PG&E's divestiture of gas gathering facilities would be a step toward a more rational market structure. It would put gas gathering assets in the hands of parties most affected by their management.

Other beneficial features of the Gas Accord include core aggregator flexibility, phasing out of PG&E's core subscription program, and assignment of Expedited Application Docket (EAD) contract shortfalls to PG&E. Core aggregator unbundling and the equity sale to SMUD, now underway in separate applications, are benefits of the Gas Accord process but are not incremental benefits of the outcome. They will go forward independent of Commission approval or rejection of the Gas Accord.

5.3 Features Opposing Approval

In our estimation, the most troublesome feature of the Gas Accord is its failure to resolve or mitigate PG&E's basic conflict between customer and shareholder interests. PG&E's position is that the Gas Accord resolves alleged conflict of interests. We disagree. The Canadian price advantage over Southwest supplies creates the opportunity to gain economic value on northern path pipelines. PG&E's present conflict of interest, accompanied by utility market power within California, results in a transfer of economic value from Southwest producers to Canadian producers, PG&E, and holders of pipeline capacity north of California. El Paso argues that PG&E's minimum bids for brokered capacity have raised Topock prices, thereby transferring value from end users to northern interests. We cannot be certain this is true, as PG&E claims that minimum bids do not affect final capacity brokering prices. At a minimum, ratepayers are harmed by loss of capacity brokering credits. PG&E argues that El Paso receives its full demand charges whether PG&E's contract capacity is used or not, and ratepayers as a whole are not harmed. PG&E is looking at the wrong group of ratepayers. It is true that total revenues paid to El Paso by ratepayers are unaffected by capacity brokering, if one assumes that incremental shippers on Line 401 that cause the loss of capacity brokering credits are also PG&E customers. However, the set of all ratepayers except the incremental shippers suffers a net loss of the forgone capacity brokering credits. That value is transferred to PG&E shareholders and northern interests.

Under the Gas Accord, loss of current capacity brokering credits would not be a major problem because PG&E's contracts with El Paso will expire at the end of 1997. However, if PG&E controls future pipeline prices or revenues for supplies from Canada and the Southwest, PG&E would retain its conflict of interest. The transfer of benefits from noncore end users to PG&E and northern interests might even be exacerbated. As long as the Canadian supply price advantage endures, which seems reasonable for the Gas Accord period, end user benefits will be linked to the delivered price of Southwest gas. Currently the market value of unused pipeline capacity from the Southwest is very small, equal to variable costs plus a contribution to fixed costs sufficient to encourage El Paso and PG&E to sell idle capacity. Under the Gas Accord, the average Topock to on-system rate would be approximately $0.165/Dth.[16] The Line 300 rate is roughly $0.15/Dth higher than market value, resulting in a transfer of economic value from end users to northern interests, even if the present balance between Canadian and Southwest gas sales to the noncore is maintained. We do not know which entities would receive those benefits, but value tends to migrate toward holders of constrained capacity. Annual harm to end users could be in the tens of millions of dollars. There would also be a small efficiency loss, relative to market prices for Line 300.

Under the Gas Accord, PG&E would retain its preference for Canadian noncore supplies, because PG&E has higher rates and would receive greater revenues from increases in throughput on its Line 400/401 in lieu of throughput on its Line 300, and PG&E's affiliate, PGT, would also receive greater revenues from increases in throughput on PGT in lieu of throughput on Southwestern interstate pipelines. PG&E could exert its market power to maximize California customer revenues by discounting service beginning at Malin (over rolled-in Line 400/401, if

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[16] Appendix B, Accord Rates, Table 2, p. 71. Topock to On-System rates would be $0.145/Dth in 1997, $0.155/Dth in 1998, $0.164/Dth in 1999, $0.169/Dth in 2000, $0.172/Dth in 2001, and $0.175/Dth in 2002. These rates include costs for Line 300 and other backbone and local transmission facilities. Malin to On-System rates for Line 400/401 are $0.238/Dth in 1997, $0.253/Dth in 1998, $0.265/Dth in 1999, $0.267/Dth in 2000, $0.269/Dth in 2001, and $0.269/Dth in 2002.

capacity is available) instead of service beginning at Topock (over Line 300). This unfair competition could cause higher burnertip gas prices in California and would harm Southwest producers and pipelines, to the eventual detriment of California end users through loss of supply diversity. Indeed, PG&E's incentive to discount only its Canadian path rates (i.e. from Malin) and not its Southwestern path rates (i.e. from Topock) could also result in unduly discriminatory discounting practices and in unfair competition between Canadian suppliers and Southwest suppliers. We cannot evaluate the benefits of supply diversity in dollar terms, but we should promote diversity by promoting fair competition among supply sources.

We cannot anticipate all future PG&E and market responses to PG&E's future conflict of interest, in the same way we did not predict backbone credit exchange agreements and other market reactions to earlier Commission decisions. However, we are convinced that under the Gas Accord PG&E would have an incentive to use market power in ways that could harm California end users and Southwest interests. Acting to keep Line 300 rates high is only one example. The conflict of interest could also extend to PG&E's use of its contracted Transwestern pipeline capacity.

Second, rolled-in rate treatment for Line 401 and the proposed path-specific unbundling scheme would be inefficient and contrary to incremental ratemaking principles. Loss of economic inefficiency is built into the averaging process because shippers would not face the costs of individual pipeline assets. In A.89-04-033, PG&E promised to insulate original system ratepayers from any risks and costs of Line 401.[17] The Commission confirmed that none of the costs of Line 401 would be allocated to original system ratepayers.[18] When PG&E determined the scale and timing of the expansion project, it took advantage of the Commission's "let the market decide" policy for new pipeline capacity, in exchange for assuming responsibility for associated costs and risks. We are obligated to defend those customer protections vigorously. Only a showing of substantial customer benefits can overcome the allocation of Line 401 costs to customers that do not need or desire Line 401 capacity. Path-specific unbundling would further obscure the incremental nature of Line 401.

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[17] Exhibits 532 and 533.
[18] D.90-12-119, Finding of Fact 41, 39 CPUC2d 69, 152 (1990).

Third, as TURN argues, allowing rolled-in ratemaking could undermine future market tests for new capacity in the gas pipeline industry and perhaps in other industries. To weaken “let the market decide” policies after construction of utility expansions could harm the Commission’s credibility. If PG&E is now allowed to roll the cost of unnecessary assets into original system rates, then future market players might be tempted to deter competition by overbuilding new capacity, hoping the Commission will later shift the risks of undersubscription or underutilization back to captive customers. Utilities and their competitors would question the Commission’s resolve in enforcing the assignment of risks and costs to the sponsors of new capacity.

Fourth, the Gas Accord holds few direct economic benefits for core customers. The Gas Accord offers immediate short-term rate reductions, but they are offset by 2.5% annual escalation through 2002. The settled escalation factor may be a reasonable estimate of general inflation, but it seems to exclude productivity opportunities, and it applies to entire transmission rates. Escalation is not restricted to cost elements that are generally subject to inflation. The embedded costs of existing pipelines are driven by sunk capital costs, not capital additions or operations and maintenance costs that might be affected by inflation.

See Appendix C to this decision for a simplified present value analysis of core and noncore benefits. The analysis shows that net core costs would be 1.2% lower under the Gas Accord, and net noncore costs would be 7.7% lower under the Gas Accord. In this instance we are principally concerned about effects on the core, because noncore parties have agreed to the Gas Accord, and noncore benefits are more substantial. The ORA represents all customers, but no party representing only core customers has endorsed the Gas Accord.

We should comment on PG&E’s characterization of direct economic benefits. PG&E offers to forgo $283 million of utility costs.[19] These customer benefits are not all assignable to the Gas Accord, but are concessions relative to PG&E’s positions in the underlying proceedings. It is possible that full litigation of the issues would result in disallowances that are higher than $283 million. The total is, however, within the overall range of dispute.

[19] The total consists of $74 million of Line 401 capital costs, $160 million of ITCS undercollections, $25 million of backbone credits, $20 million of EAD shortfalls over the Gas Accord period, and $3.7 million of reasonableness review payments.

Fifth, we are concerned that the Gas Accord does not fairly reflect the interests of core customers or Southwest producers and pipeline companies. PG&E has settled with: (1) noncore customers, (2) ORA as a representative of all customers, (3) most Line 401 firm shippers, and (4) individual parties with narrow interests. Noticeably absent are TURN, El Paso, and New Mexico. The fairness of representation in a settlement is a matter of judgment, but the exclusion of PG&E's competitors is especially troubling. We disagree with the suggestion of CIG and CMA that we should not expect competitors to come together in settlements. In comments to the proposed decision, PG&E describes the Gas Accord as an all-party settlement, and characterizes Gas Accord signatories as "the market itself." The claims are overblown. Representatives of core customers, noncore customers, and Southwest interests oppose the Gas Accord.

Sixth, we are uncertain about the disposition of Edison's $80 million termination payment to PG&E. Edison may seek to include in rates the cost of its payment, and PG&E may intend to retain the payment instead of using it to reduce the rolled-in revenue requirement for Line 400/401.

5.4 Conclusion

We will approve the Gas Accord. In our judgment, the persistence of PG&E's conflicts of interest can be reasonably mitigated by future Commission proceedings concerning matters not specifically addressed by the Gas Accord and by our imposition of a discounting rule in this order. With continued Commission oversight concerning PG&E's conflicts of interest and with certain policy clarifications and the discounting rule discussed in Chapter 6 below, we find that the Gas Accord is reasonable in light of the whole record, consistent with law, and in the public interest.

We are impressed with the breadth of support for the Gas Accord. PG&E, utilities and other transportation customers of Line 401, and representatives of both core and noncore customers have settled many difficult economic and regulatory issues. Asset-based unbundling of PG&E's gas transportation service would be preferable to the settled path-based unbundling, but PG&E's acceptance of responsibility for revenue requirements without balancing account treatment offsets that defect. Increased costs associated with partial roll-in of Line 400 and Line 401 costs will be borne by noncore customers that freely entered into the settlement. Direct benefits to the core are smaller than benefits to the noncore, but core customers will benefit from seasonal reservations of pipeline capacity and access to Line 400 service at vintaged rates. All customers will benefit from regulatory certainty during the Gas Accord period, and from resolution of ITCS and backbone credit issues, as discussed in Chapter 8 herein.

Pursuant to Rule 51.1(e) of the Commission's Rules of Practice and Procedure, we specifically find that the Gas Accord is reasonable in light of the whole record, consistent with law, and in the public interest, because it represents a significant improvement over PG&E's currently bundled rates and services, provides PG&E's customers with greater flexibility and competitive alternatives, and resolves rate issues within the zone of reasonableness such that we can find PG&E's rates to be just and reasonable. It is not clear that PG&E's rates would be as favorable for its ratepayers through continued litigation as the rates provided in the Gas Accord, and, as discussed elsewhere in this decision, the resolution of the rate issues in the Gas Accord represents a fair accommodation of the various arguments in the litigation in the proceedings.

The problems we have identified with the Gas Accord primarily focus on how the Gas Accord does not go far enough in mitigating PG&E's conflicts of interest and the resulting unfair competition concerning PG&E's marketing of Line 400/401 and use of Line 300 and in mitigating potential conflicts of interest in PG&E's procurement of gas for its core customers. We are also concerned that the Gas Accord has not provided enough unbundling and that parties may attempt to improperly cite our approval of the Gas Accord as a precedent in favor of rolled-in rates (when our policies continue to be in favor of incremental rates) or that parties will claim that the Gas Accord resolved numerous issues which were never specifically addressed by the Gas Accord. Rather than reject the Gas Accord in light of these concerns, we believe that the much better course is to approve the Gas Accord in light of its improvement over PG&E's present rates, to narrowly interpret the Gas Accord and our order approving the Gas Accord so that it will not limit our ability to further address PG&E's conflicts of interest and unbundling issues, to clarify our policies and various ambiguities in the Gas Accord so that parties will not misinterpret this decision and to impose a discounting rule in this order to address PG&E's marketing conflicts of interest. Nothing in the Gas Accord gave PG&E complete discretion in its discounting of its services, and we will therefore impose a discounting rule which we believe will mitigate PG&E's conflict of interest (between its marketing of Line 400/401 services and use of Line 300) and provide for fairer competition between shippers accessing Canadian, California, or Southwest suppliers.

We will continue to scrutinize PG&E's procurement of gas for its core customers and will not hesitate to impose penalties or disallowances if PG&E's CPIM proves to be inadequate in protecting PG&E's ratepayers from PG&E's conflicts of interest. We would note in this regard, that our approval of the Gas Accord in no way prejudices our consideration or approval of rules addressing affiliate abuse issues, or our consideration or determinations concerning PG&E's procurement practices based upon our review of the reports PG&E is required to file under the Gas Accord. We also intend to go forward with our Natural Gas Strategic Plan to consider and implement unbundling polices beyond the unbundling in the Gas Accord, as well as to consider other means to produce a more competitive gas market for all classes of utility customers.

In our discussion below, we also make it crystal clear that our approval of the Gas Accord cannot be cited as a precedent in favor of rolled-in rates, and we further clarify ambiguities concerning other issues in the Gas Accord.

Accordingly, we find that the Gas Accord is in the public interest subject to the discounting rule in this order and the Commission's continued oversight in subsequent Commission proceedings of PG&E's rates, services, and practices.

6. Related Issues

In approving the Gas Accord, we must clarify our intentions about several issues related to PG&E's gas transportation service.

6.1 Decision to Construct

We accept the Gas Accord's resolution of reopened proceedings on PG&E's decision to construct Line 401, but we must review the record in order to address deceit claims made by Norcen.

6.1.1 Res Judicata

PG&E submits that there is no lawful basis to reopen the finding of reasonableness in D.94-02-042. PG&E cites the legal doctrine of *res judicata*, under which a matter decided by a court of competent jurisdiction is decided finally.

In reply briefs, TURN, Norcen, and Edison counter PG&E's *res judicata* argument by citing Commission authority under Public Utilities (PU) Code § 1708. Edison has since disavowed its position, but its legal arguments are part of the record.

We reject PG&E's argument that reopening the decision to construct is unlawful. PU Code § 1708 specifically allows the Commission to rescind, alter, or amend any of its orders or decisions after notice and opportunity to be heard. Although *res judicata* rules apply generally to Commission orders, they should be administered more flexibly than in the judicial system.[20] In the present circumstance, the discovery of new evidence provided ample justification for the reopening.

6.1.2 Positions of Parties

According to PG&E, the existence of the McLeod memo was revealed in earlier cross-examination, and PG&E did not mislead the Commission or the parties by not volunteering its contents. The McLeod memo reveals a set of reasons for building the expansion project that are somewhat different from the reasons set forth in PG&E's testimony, but PG&E claims its testimony sets forth the actual reasons that management made its decision, not the reasons supported by PG&E staff in the memo. PG&E argues that Norcen's Rule 1 allegations are not based on new evidence, but are only another version of a contract suit against PGT now underway in a different forum; Norcen's attempt to rescind its contract for firm service on the PGT portion of the expansion belongs in court, not before the Commission.

In laying a foundation for its deceit claim, Norcen makes several arguments against the reasonableness of PG&E's decision to construct. First, Norcen asserts that there was not sufficient market demand for Line 401 to avoid underrecovery of the revenue requirement. Instead, PG&E relied on the commitments of shippers with signed contracts on the PGT portion of the expansion. Those shippers would "of necessity" use Line 401 for transportation service in California.[21] Norcen points out that the reasons for the recommendation to build contained in the McLeod memo are different from the reasons in PG&E's earlier testimony. The McLeod memo emphasizes the irrevocable commitment of upstream shippers, PG&E's "first mover" advantage over a pipeline proposed by Altamont Gas Transmission Company (Altamont), and loss of a $44 million supplemental payment from TransCanada PipeLines Ltd. (TransCanada) if the expansion project was canceled. Norcen's witness Sheldon Reid testified that Norcen never

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[20] Arakelian Farms, Inc. v. Agricultural Labor Relations Bd., 49 Cal. 3d 1279, 1290 (1989).

intended to take Line 401 service, but signed a contract for PGT service in order to deliver Canadian gas to Malin.[22] Norcen assumed that downstream shippers taking that gas would have access to rolled-in rates in California. Norcen accuses PG&E of sharp business practices because PG&E surreptitiously planned to pursue the crossover ban at the time Norcen signed its PGT contract.

TURN argues that PG&E unreasonably went forward with the expansion based on a view of market demand rooted in PG&E's attempts to avoid or reverse two Commission requirements: incremental ratemaking, and firm contracts for Line 401 capacity. El Paso agrees with Norcen that the Altamont threat and the TransCanada payment were major drivers of the decision to construct. New Mexico claims that PGT subscriptions did not necessitate Line 401 loads, because PG&E had notified PGT shippers that lack of market support would result in reduced physical facilities on the California side. New Mexico argues that sufficient firm contracts for Line 401 service were not in place, that supply basin economics did not support the project, and that Altamont and TransCanada considerations are insufficient for a finding of reasonableness. CAPP concurs that market support for the expansion was inadequate, and asks for Commission findings that will assist individual shippers entrapped by PG&E into PGT capacity commitments.

6.1.3 New Evidence

We are faced with new evidence that falls into three categories: (1) the McLeod memo and supporting documents and testimony; (2) discovery documents and testimony presented by Norcen, El Paso, and TURN; and (3) information about stranded cost risks addressed in A.89-04-033, the Line 401 certification proceeding. We have carefully reviewed this evidence, but we have not attempted to reinterpret or recharacterize evidence taken during earlier phases of this proceeding.

The McLeod memo sets forth reasons to construct Line 401 that clearly differ from reasons in PG&E's earlier testimony. During 1993 hearings, PG&E presented five related factors in support of its October 25, 1991, decision to commence construction of the expansion project:[23]

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[21] Exhibit 455, Bates 000679.
[22] Tr. 70:9093.
[23] Exhibit 6, p. GJB-7.

(1) upstream PGT capacity was fully subscribed, confirming market intent to support the overall expansion project; (2) more than 80% of Line 401 capacity was subscribed by firm shippers, although their commitments included various termination rights; (3) PG&E proceeded only after contracts with anchor shippers Edison and SDG&E were fixed; (4) there was no shipper interest in Line 401 capacity that might be less than upstream PGT capacity; and (5) Canadian gas at the northern end of the pipeline was abundant and competitively priced. The McLeod memo does not present its reasons as succinctly, but summarizes three: (1) although there was uncertainty about rate design issues before this Commission, revenue recovery was not an issue because California shippers were irrevocably contracted on upstream pipeline segments; (2) target throughputs were attainable, due to sound economics and full subscription of PGT capacity; and (3) deferral of the project was an ineffective option because it would increase construction and financing costs. The memo goes on to discuss project economics, management of regulatory risk, and competitive positioning. The project economics are supported in the attached study by McKinsey & Company. Regulatory risks resided primarily on the California segment of the pipeline. The expansion's competition was the Altamont project. Cancellation risked loss of the TransCanada payment.

Notwithstanding this discrepancy in PG&E's testimony, we will not change our ruling on the reasonableness of PG&E's decision to construct its expansion. PG&E was placed at risk for any revenue shortfalls due to the undersubscription of its Line 401, and, therefore, PG&E's shareholders had to absorb the revenue shortfalls to the extent that Line 401 was not fully subscribed, was not fully utilized, or was utilized but at discounted rates. Moreover, nobody forced PGT's expansion shippers to sign firm service agreements with PGT. PG&E apparently believed that the full subscription to PGT's expansion inevitably would result in market support for PG&E's Line 401.

We are concerned, however, that PG&E might not have testified in our previous proceeding as to the whole truth when it omitted in its 1993 testimony mention of competition from Altamont or the TransCanada payment and when it mischaracterized the level of firm commitments to its Line 401.

In D.94-02-042, the Commission found the decision to construct to be reasonable because the certification decision did not assign stranded costs to shareholders, other Commission decisions protected shareholders from indirect costs of stranded capacity, and discounting limits would minimize stranded costs.[24] New evidence on actual market transactions show that discounting limits do little to minimize stranded costs. The limits are low enough--approximately $0.08/Dth--that PG&E retains a strong incentive to favor Line 401 sales over brokering of unused Southwest capacity, resulting in increased ITCS obligations to original system ratepayers.[25] Yet, in A.89-04-033 itself and in the subsequent amended application, PG&E assured the Commission:[26]

> "The cost of the service provided by the Expansion Project will cover the incremental costs of the new facilities and will not include any costs of PG&E's existing gas transmission system. Under this cost allocation proposal, PG&E's existing gas customers will be <u>insulated from any risks</u> associated with the Expansion Project, unless they also receive service on the Expansion Project." (Emphasis added.)
>
> * * *
>
> "Under this incremental cost allocation proposal, PG&E's existing utility gas customers who do not also receive service over the Expansion Project are <u>insulated from any costs or risks</u> associated with the Expansion Project." (Emphasis added.)

Two PG&E witnesses testified to the meaning of the promise. The first witness was Richard Clarke, PG&E's Chairman of the Board and Chief Executive Officer in 1989, when PG&E filed A.89-04-033. In response to a question by the ALJ, Clarke testified:[27]

> Q Does it mean that existing gas customers will be insulated from risks associated with stranded costs?
>
> A I don't see that here. But I guess to pursue, if stranded can be easily defined and distinguished from slack, then I assume that would also flow.

Slack capacity is capacity in excess of demand needed to generate the benefits of competition. Stranded capacity is unused capacity beyond slack capacity.

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[24] D.94-02-042, Finding of Fact 11, 53 CPUC2d 215, 248 (1994).
[25] Exhibit 228.
[26] Exhibits 532 and 533.
[27] Tr. 72:9488, regarding Exhibit 532.

The second witness was Geoffrey Bellenger, PGT's Manager of Gas Supply and Regulatory Affairs in 1989. The quoted excerpts from A.89-04-033 were prepared under his supervision. Bellenger noted that the first excerpt is found under the heading "Financing and Rates" and goes to the cost allocation proposal in the application. In response to questions by the ALJ about specific meaning, Bellenger testified:[28]

> A And I think what it's saying is that PG&E existing customers will not have to pay any of the costs of the pipeline expansion project.
>
> And in this context, in 1989, it can only be talking about the direct costs of the project--the costs that are used to establish the revenue requirement and the rates--and that the risks associated with the project would be PG&E's ability to recover that revenue requirement in the market.
>
> Q Why do you think it's limited to direct costs?
>
> A Because if there was any indication at the time from the Commission, or anywhere else, that PG&E would be exposed to indirect costs, I just have to believe that there would have been something in the application to address that issue.
>
> And my own personal recollection: At the time we put this together, there was no such indication. And this was a traditional approach to financing and ratemaking; and this was to give the Commission the assurance that the direct costs of the project would not be borne by the existing ratepayers.

In D.94-02-042, the Commission found that shareholders should not bear the costs of stranded capacity on interstate pipelines or PG&E's original pipeline system. It did so in large part because the certification decision did not explicitly assign indirect stranded costs to shareholders. The Commission stated:[29]

> "In D.90-12-119, we could also have assigned to shareholders the costs of stranded capacity, but we did not. To make such an assignment now would unfairly impose a new performance standard on PG&E."

[28] Tr. 73:9586, regarding Exhibit 532.
[29] D.94-02-042, 53 CPUC2d 215, 227 (1994).

We now see that this performance standard was not new, but was embodied in the explicit promises made by PG&E in A.89-04-033. PG&E stated unequivocally that original system ratepayers would be "insulated from any costs or risks associated with the Expansion Project." PG&E witness Bellenger attempts to limit those risks to the direct costs of Line 401, on the grounds that PG&E had no notice to the contrary. We cannot accept this limitation. The meaning of the risk protection statements in A.89-04-033 is unambiguous. No interpretation is necessary. PG&E's Chairman of the Board at the time admits as much, as long as stranded capacity is distinguished from slack capacity.

PG&E's assumption of revenue requirement risks and agreement to bear ITCS costs under the Gas Accord is a logical consequence of its earlier commitments. Thus, while we will not change our finding on PG&E's reasonableness to construct its expansion, we believe that PG&E should bear more responsibility for its risks and stranded costs than it has in the past and we find that the Gas Accord provides a reasonable resolution of this issue.

6.1.4 Deceit Claim

Norcen asks for specific relief in its dispute with PG&E. Norcen seeks: (1) findings that PG&E's decision to construct the expansion was unreasonable, and that PG&E deceived the market into becoming captive to PG&E's designs, which were antithetical to market signals; (2) use of 95% load factors in Line 401 rate calculations; (3) an order requiring PG&E to accept permanent release of Norcen's contracted capacity on PGT and Canadian pipelines, without adverse economic consequences to PG&E ratepayers; and (4) an order setting hearings to determine the amount and extent of stranded costs caused by PG&E, and eventual removal of stranded capacity from rate base and removal from rates of the costs of stranded interstate capacity.

These seem to be the key events within a massive record: On January 22, 1991, FERC issued the decision that allowed shippers to use Malin as a delivery point on the PGT portion of the expansion. On January 29, 1991, PGT wrote potential shippers a letter assuring them that PGT would keep them informed as events unfold at FERC and the Commission.[30] On

[30] Exhibit 521.

February 20, 1991, PG&E Vice President John Keyser wrote PGT President Stephen Reynolds to warn that failure to contract for firm capacity on the PG&E segment of the expansion would result in California physical facilities that do not match PGT expansion capacity.[31] On the same day, PG&E transmitted a package of documents--including the Keyser letter--to prospective shippers.[32] Norcen (or Bonus Energy, Inc., Norcen's predecessor in interest) received the Keyser letter. On February 26, 1991, Reynolds wrote Commission President Patricia Eckert to propose, among other actions, what is now known as the crossover ban.[33] On April 23, 1991, PG&E filed with FERC a pleading seeking the crossover ban.[34] Sheldon Reid, now Vice President of Norcen, testified that Norcen did not receive either a copy of the FERC pleading or news of its existence before April 25, 1991, when Norcen signed its firm service contract with PGT.[35]

Norcen asserts that the failure of PG&E or PGT to inform Norcen of utility intentions to pursue the crossover ban, in the face of Norcen's intention not to take service on Line 401, was part of a covert campaign to force PGT shippers to use Line 401 for deliveries to Northern California. According to Norcen, such strong-arm efforts were deceitful and contrary to shipper intentions, and they justify the requested relief. CAPP supports Norcen's request for findings of impropriety, but concedes that the Commission is not empowered to administer the requested contract remedies.

PG&E and PGT argue that Norcen's allegations of deceit or breach of promise are unsupported by the facts. They point to a Norcen internal memorandum dated February 5, 1991, which expresses concern about PGT's "stated position on 'no cross-over' between the new PGT Expansion and the new PG&E Expansion at Malin...."[36] The memo suggests that Norcen knew of PGT's intent before it signed its PGT contract. PG&E and PGT claim the dispute between Norcen and PGT is a contract matter that should be decided by the courts, not the Commission.

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[31] Exhibit 476.
[32] Exhibit 480, Attachment 2, ref. Item 8.
[33] Exhibit 477.
[34] Exhibit 498.
[35] Tr. 69:9007.
[36] Exhibit 480, Attachment 5.

PG&E notes that the alleged misdeeds by PG&E and PGT occurred prior to execution of Norcen's contract with PGT. Therefore, contract principles cannot be applied.

We will not make the findings sought by Norcen. Although we are concerned about some of PG&E's actions, we will not grant Norcen the relief it seeks. At most, PG&E and PGT sent mixed signals to shippers. The February 5, 1991, Norcen memorandum clearly shows that Norcen understood PGT's position regarding crossover. The February 20, 1991, letter from PG&E to PGT indicates that PG&E's solution to mismatched demand for PGT and PG&E service was to build less capacity in California. In a deposition before Norcen attorneys, PGT Senior Vice President Paula Rosput understood that some successful PGT bidders might not seek to contract for firm capacity south of Malin.[37] Yet PGT's Manager of Gas Supply and Regulatory Affairs testified that there was no shipper interest in Line 401 capacity that might be less than upstream PGT capacity. The PG&E steering committee endorsed that assessment in October 1991, six months after the PGT portion was fully subscribed, despite the fact that firm capacity commitments had not filled Line 401. Obviously PG&E did not carry out its threat to build less than matching capacity south of Malin. Did PG&E interpret shipper reluctance to sign Line 401 contracts as a bluff rather than a lack of interest? Did PG&E really believe those shippers would eventually contract for matching Line 401 capacity "of necessity?" If so, what was the point of the warning in the February 20, 1991, letter regarding lower than matching capacity in California? We do not have good answers to these questions, but we do not intend to interpret the mixed signals sent during contract negotiations.

Turning to other relief requested by Norcen, load factors within rate calculations are resolved by the Gas Accord. We will deny Norcen's request for an order to accept release of Norcen's PGT capacity. As a policy matter, Norcen's contract dispute with PGT belongs in the court where it began, not before the Commission. We need not address the jurisdictional arguments of PG&E and PGT. Finally, it is not necessary to convene hearings on stranded costs.

[37] Exhibit 537, pp. 191-194.

6.2 Rule 1 Allegations

In the motion that led to the reopening of the decision to construct, Norcen and TURN recommend that the Commission assess whether PG&E's nondisclosure of the McLeod memo violated Rule 1 of the Commission's Rules of Practice and Procedure. Norcen and TURN submit that if PG&E had properly disclosed the McLeod memo, there is a strong expectation that the Commission would alter its findings that PG&E's decision to construct was reasonable.

Rule 1 is a code of ethics that requires any person appearing before the Commission to agree "never to mislead the Commission or its staff by artifice or false statement of fact or law." Such misleading conduct can include omission of facts that might influence a Commission decision, if the omission is intentional or caused by reckless or grossly negligent actions. In the present context, reckless behavior can be acts or omissions that are heedless or inattentive to material consequences.[38]

We perceive two possible areas of misbehavior. First, PG&E may have misled the Commission in PG&E's testimony on the reasons behind the management decision to construct the expansion. Omitted from the reasons PG&E provided for its decision to construct its expansion was its intention to gain the first mover advantage over the competing Altamont project, and the potential loss of a $44 million payment from TransCanada. As well, it appears that fewer shippers had contracts for Line 401 capacity than what PG&E represented to the Commission. The McLeod memo shows that in October 1991 PG&E held signed contracts for less than 25% of Line 401 capacity,[39] contradicting the earlier assertion that more than 80% of Line 401 capacity was subscribed by firm shippers. PG&E characterized the Edison and SDG&E commitments to Line 401 as being "fixed," but contracts were not yet signed. As discussed above, we no longer question the reasonableness of PG&E's decision to construct, even after review of the McLeod memo, but it appears that the disparities between PG&E's earlier testimony and the later-revealed McLeod memo may constitute a Rule 1 violation. Moreover, if PG&E's witness knowingly misled the Commission with PG&E's earlier testimony, this would constitute a felony under Section 2114 of the California Public Utilities Code.

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[38] Black's Law Dictionary, Revised Fourth Edition, p. 1435 (1968).
[39] Exhibit 455, Attachment 1, Bates 000687.

Second, should the Commission impose penalties on PG&E for failure to provide the McLeod memo to other parties in response to explicit discovery requests? Edison, the Indicated Expansion Shippers, and New Mexico requested information of the type contained in the McLeod memo. In its Data Request No. 2, Q6, Edison requested "all documents that relate to PG&E's determination that there was sufficient demand to justify construction of the Project."[40] The McLeod memo certainly contains such information, and PG&E provided Edison with five paragraphs from the memo, claiming business confidentiality and attorney-client privilege for the rest of the document. PG&E did not provide or identify all documents as requested, but provided the excerpted paragraphs from internal documents "illustrating" factors considered by PG&E. In his first data request, consultant Thomas Beach, then a witness for the Indicated Expansion Shippers and more recently a witness for successor organization CAPP, sought identification of withheld documents and "a copy of all data requests obtained from any other party and all responses provided by PG&E to such data requests."[41] Beach later specifically asked for PG&E's answer to Edison's Second Data Request, Q6.[42] Neither CAPP nor the Indicated Expansion Shippers received a copy of the redacted McLeod memo that PG&E provided to Edison. New Mexico asked PG&E to provide all documents that discuss load factors for firm or as-available service on Line 401.[43] The McKinsey & Company study attached to the McLeod memo discusses demand forecasts, throughput levels, and utilization percentages, arguably the same measures of expansion project usage as load factor. New Mexico did not receive from PG&E either the McLeod memo or its identification as a confidential document.

The evidence in dispute, and PG&E's failure to produce or identify the McLeod memo in discovery, causes us to be very concerned that PG&E may have violated our rules, including Rule 1 of the Commission's Rules of Practice and Procedure. Unfortunately, the parties to the Gas

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[40] Edison March 10, 1995, response to motion to reopen, attached Exhibit "A", p. A-2.
[41] Norcen and TURN February 24, 1995, motion to reopen, attached Exhibit 3, Question A.6 and Question B.2.
[42] Norcen and TURN February 24, 1995, motion to reopen, attached Exhibit 5, Question 4.
[43] New Mexico March 10, 1995, response to motion to reopen, attached Exhibit "A", Question 16.

Accord, including ORA, erroneously believed that they could settle the alleged Rule 1 violations, and therefore, the termination of the Rule 1 allegation proceeding is a part of the Gas Accord.

The sanctity of the Commission's rules is not a matter that private parties or the ORA can settle. Violations of our rules cannot be forgiven or traded for other concessions. Only the enforcement staff of the Commission (e.g., Consumer Services Division or other authorized enforcement staff) can negotiate a settlement with a utility involving Rule 1 violations, subject to an independent determination by the Commission as to whether or not to approve that settlement. The settlement of such violations should not be merged into a settlement of other unrelated issues.

For this reason, when the Commission sees provisions settling Rule 1 violation allegations in a settlement involving private parties or the ORA, or any other provision parties have no lawful authority to settle, we will disregard the provision and consider it an *ultra vires* or unauthorized act. Under Rule 51.7 of the Commission's Rules of Practice and Procedure, we normally would allow parties a reasonable time to decide if Commission modifications to a settlement are acceptable. However, we do not consider striking an unauthorized or *ultra vires* provision to be a modification of a settlement, since the provision is a legal nullity. Therefore, if we consider the settlement to be otherwise in the public interest by striking unauthorized or *ultra vires* provisions, we do not view that as modifying the settlement under Rule 51.7 of our rules, and we instead consider the adoption of the settlement to be binding on the parties under Rule 51.8 of the Commission's Rules of Practice and Procedure. Accordingly, we will ignore the Rule 1 provision of the Gas Accord.

After the alternate proposed decision of Assigned Commissioner Richard A. Bilas and Commissioner Josiah L. Neeper was mailed on June 11, 1997, PG&E met with representatives of the Commission's Consumer Services Division in order to negotiate a settlement and attempt to obviate the need for an Order to Show Cause proceeding concerning PG&E's alleged Rule 1 violations. On July 1, 1997, the Consumer Services Division submitted to the Commission a settlement between PG&E and the Consumer Services Division concerning the alleged Rule 1 violations (hereinafter the "Rule 1 Settlement"). The Rule 1 Settlement is attached to this order as Appendix E.[44]

The major provisions under the Rule 1 Settlement provide that, without admitting that it has committed a Rule 1 violation, PG&E would make a payment of $850,000 to the General Fund for the State of California, which would not be recorded as an operating expense by PG&E for ratemaking purposes. PG&E has further agreed in the Rule 1 Settlement that its professional-level employees, who routinely practice before the Commission, would take an ethics training course of at least four hours (and up to one full day) regarding the preparation and processing of discovery and prepared testimony.

After reviewing the Rule 1 Settlement between PG&E and Consumer Services Division, we conclude, pursuant to Rule 51.1(e) of our Rules of Practice and Procedure, that the settlement is a reasonable resolution of the alleged Rule 1 violations in light of the whole record, that it is consistent with law, and that it is in the public interest. We therefore adopt the Rule 1 Settlement in its entirety.

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[44] Since private parties, other than the company allegedly committing the Rule 1 violations, have no right to participate in settlement concerning the alleged Rule 1 violations, there would be no reason to apply the comment periods normally provided under Rule 51.4 of our Rules of Practice and Procedure to the Rule 1 Settlement. Accordingly, pursuant to Rule 87 of our Rules of Practice and Procedure, we will sua sponte waive the 30-day comment period and 15-day reply period in Rule 51.4 in order to expeditiously rule on the Rule 1 Settlement.

PG&E's agreement under the Rule 1 Settlement to pay $850,000 represents a substantial compromise by PG&E of alleged improprieties which, if proven, could lead to very serious consequences. Moreover, PG&E's agreement to have its employees, who routinely appear before the Commission, attend at least four hours of ethics classes, should help ensure that in the future PG&E's employees will not misrepresent matters or mislead the Commission whether or not PG&E employees have done so in the past.

In view of PG&E's substantial compromises in the Rule 1 Settlement, we see no point to issuing an Order to Show Cause instead of approving the Rule 1 Settlement. Indeed, the Rule 1 Settlement avoids a protracted Order to Show Cause proceeding, and it is not clear that the proceeding would have resulted in fines equivalent to the amount of money PG&E has already agreed to pay. Moreover, PG&E's agreement to have employees attend an ethics training course should help prevent problems in the future.

We want to emphasize to PG&E that we will not tolerate any violations of our rules. We will not allow utilities or any other parties to play fast and loose with our rules, and we expect PG&E management to take extra steps to ensure that its employees or agents strictly adhere to our rules and regulations when they represent PG&E in Commission proceedings.

6.3 Natural Gas Strategic Plan

In comments to the ALJ's proposed decision, TURN argues that adoption of the Gas Accord will preclude revisions to PG&E's rates and services that might otherwise be ordered in the wake of the Commission's upcoming Natural Gas Strategic Plan (Plan). Several Gas Accord signatories disagree, claiming that the settlement will encourage progress toward future policy changes by resolving regulatory disputes over PG&E's past actions.

PG&E asserts that the Gas Accord is consistent with the Plan and will not tie the Commission's hands in the future. PG&E states:[45]

> "The Accord does not preclude the Commission's review of numerous other issues, such as core rate deaveraging or customer rate design, which are currently examined in Biennial Cost Allocation Proceedings. The Accord makes significant movement toward a more competitive procurement market, but does not limit

[45] PG&E Reply Comments on the ALJ's Proposed Decision, filed April 30, 1997, p. 3.

> additional steps, such as an examination of the role of utility core procurement as core aggregation increases. …In addition, the Accord does not address changes in reliability standards, qualifications for electric generation rates in a post-divestiture environment, or the interactions of the electric industry and natural gas market unbundling at the distribution level. All of these important issues can be appropriately addressed in a state-wide strategic review."

PG&E is correct that approval of the Gas Accord does not preclude the Commission from moving forward on various other important natural gas issues. Our intention in the Plan is to review the structure of the industry and specific approaches to rate decisions, unbundling, market entry and related topics so as to promote a more competitive marketplace. While there are significant differences between the electric and natural gas industries, we intend to consider the electric industry model (and direct access for all customers classes in particular) for its applicability to the natural gas industry. It is possible that the natural gas strategic plan will lead to consideration of issues similar to or extended from issues addressed in the Gas Accord. It is our intention to fulfill the intent of the Gas Accord to provide stable and predictable backbone transmission rates throughout the Gas Accord period, as well as to see that its other provisions are fairly and properly implemented. However, if necessary, we will not hesitate to consider whether changes to Gas Accord issues should be made before the end point of the Accord in order to facilitate overarching policy goals. While we will respect the spirit of the settlement, it is not necessary to pledge that in the natural gas strategic plan the Commission will not consider changes to the Gas Accord given appropriate notice and due process.

We will not delay approval of the Gas Accord in order to consider the Plan, but we intend to hold PG&E to its word that our approval of the Gas Accord will not limit the Commission's authority if the Plan requires changes to PG&E's ratemaking structure or to PG&E's services. Even without PG&E's recognition of possible changes, we may revisit Gas Accord issues pursuant to PU Code § 1708.

6.3.1 Rolled-In Rates

Although we are approving the Gas Accord, we remain concerned that the partially rolled-in rates for Line 400 and Line 401 are contrary to our incremental ratemaking principles. PG&E was authorized to build Line 401 based upon its pledge to utilize incremental rates, and PG&E assured us at that time that PG&E's existing customers would not have to pay for Line

401 costs. Approval of partially rolled-in rates for noncore customers is reasonable here, but only because noncore representatives have agreed to it in the Gas Accord, presumably in return for other benefits. Full roll-in of Line 401 costs would increase core rates and would significantly conflict with our policies. However, the Gas Accord does not provide for fully rolled-in rates; it protects core retail and core wholesale ratepayers from the unjustifiable increase in rates which would result from the rolled-in rates. Therefore, our finding that the Gas Accord is in the public interest is predicated on the fact that the core retail and core wholesale customers will continue to benefit from low, vintaged rates on Line 400 and will not have to pay for Line 401 costs. We would strongly disfavor any future PG&E request for full roll-in of Line 401 costs if such roll-in would increase either core or noncore rates (absent an all-party settlement), whether such a request occurred before or at the expiration of the Gas Accord.

6.3.2 Core Procurement

TURN raises an important issue about PG&E's core procurement practices. TURN fears that penalties accruing under the adopted CPIM may not be sufficient to deter PG&E from taking actions that benefit shareholders to the detriment of core customers. TURN then suggests that an independent procurement officer (IPO) can mitigate this problem. PG&E responds:[46]

> "[E]mploying a performance-based ratemaking mechanism does not remove a utility's procurement practices from the scrutiny of the Commission. The Post-1997 CPIM assumes a quarterly and annual reporting requirement. If Southwest gas became the least-cost supply option and PG&E continued to procure more-expensive Canadian supplies for the core, such behavior would certainly come to the Commission's attention. PG&E assumes that penalties for behavior favoring shareholder interests at the expense of core interests would not be limited to those accrued under the CPIM."

* * *

> "[I]f the Commission believes that an independent procurement mechanism may be an appropriate alternative, the Commission could initiate a proceeding to evaluate the concept and set a procedural schedule for such examination after a decision on the Gas Accord is issued."

[46] PG&E Supplemental Report Describing the Post 1997 Core Procurement Incentive Mechanism (CPIM), dated October 18, 1996, pp. 1-8 and 1-9.

We agree with PG&E that the CPIM will not be the sole device by which the Commission will protect PG&E's ratepayers to the extent that PG&E puts its shareholder interests ahead of ratepayer interests and PG&E unreasonably purchases gas at prices higher than available alternatives. We can consider this matter in affiliate abuse proceedings and other proceedings, and disallowances or penalties for PG&E's behavior favoring shareholder interests over ratepayer interests are not just limited to scenarios in which Southwest gas is the lowest cost core supply. We intend to look carefully at any situation where utility costs of core procurement are unreasonably high due to PG&E's conflicts of interests. Possibilities include CPIM operations, interstate gas swaps with affiliated pipeline operations, and affiliate abuses in general. In order to stay informed about PG&E's core procurement practices, we will require PG&E to file core procurement reports quarterly and annually as provided in the Gas Accord.

While we do not place total reliance on PG&E's CPIM for protecting PG&E's ratepayers, we nevertheless believe that the CPIM is in the public interest for increasing PG&E's incentive to minimize its procurement costs for its core customers. Therefore, subject to our continued oversight to address any procurement abuses, we will approve the revised 1994-97 CPIM, as well as the post-1997 CPIM. Moreover, the Commission may still initiate a proceeding to consider requiring an IPO, so we reserve the right to do so notwithstanding our approval of the CPIM.

6.4 Discounting

We will not find that the Gas Accord is reasonable or in the public interest without mitigation of PG&E's future conflict of interest under the settlement wherein PG&E will continue to favor its Malin to on-system path (Line 400/401) over its Topock to on-system path (Line 300) or its California production to on-system path (California Gas Production Path). We cannot allow PG&E to maximize transportation rates on Line 300 or its California Gas Production Path by refusing to discount the tariff rate, then discounting rolled-in Line 400/401 service to compete with these other rates at the burnertip.

On June 11, 1997, Assigned Commissioner Richard A. Bilas and Commissioner Josiah L. Neeper mailed an alternate proposed decision to all parties, which indicated that the Commission intended to issue an Order Instituting Rulemaking (OIR) to address a proposed discounting rule. In the comments filed on the alternate proposed decision, numerous parties urged the Commission to address the discounting rule in the order on the Gas Accord rather than in a separate OIR proceeding. Therefore, on

June 24, 1997, Commissioner Richard A. Bilas issued an Assigned Commissioner's Ruling Regarding Alternate Decision asking parties to comment on two issues. The first issue was a proposed rule that "PG&E shall offer a commensurate discount on Line 300 whenever offering any discount for Line 400/401 or Line 401 Service. This rule does not apply to off-system sales." The parties to the Gas Accord were specifically requested to indicate if they all could accept this rule, in which case it could be accepted into the Alternate Order. The second issue was whether to adopt TURN's proposal of crediting $94.1 million to the Core Fixed Cost Account (CFCA). Comments were due by July 1, 1997, and nine comments were filed on that date.

In comments responsive to the Assigned Commissioner's Ruling, almost all of the signatories to the Gas Accord stated (or authorized others to state) that they supported or did not oppose a discounting rule (with certain clarifications) as an amendment to the Gas Accord.[47] However, in its July 1, 1997 comments, the City of Palo Alto, a signatory to the Gas Accord, objected to having the discounting rule become part of the Gas Accord. Therefore, on July 2, 1997, Assigned Commissioner Richard A. Bilas and Commissioner Josiah L. Neeper mailed a revised, alternate proposed decision to all parties, which noted the City of Palo Alto's opposition to the discounting rule and again indicated that the Commission intended to address this matter in a separate OIR. The July 2, 1997 revised, alternate proposed decision clarified that the proposed discounting rule would require PG&E to offer to all shippers a commensurate discount (i.e., penny for penny) on Line 300 and its California Gas Production Path whenever offering any discount to any shipper for similar Line 400/401 services (e.g., as-available services).

The July 2, 1997 mailing of the revised, alternate proposed decision resulted in another round of initial and reply comments. In their initial comments, the signatories to the Gas Accord (except the City of Palo Alto) represented that they supported or did not oppose amending the Gas Accord to include the discounting rule as clarified in the July 2, 1997 revised, alternate

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[47] In sharp contrast to the discounting rule, most of the signatories to the Gas Accord indicated that adoption of TURN's CFCA proposal would substantially modify and upset the balance in the Gas Accord. In addition, supporters of the Gas Accord challenged the support in the record for the TURN CFCA proposal, and indicated problems of attempting to address the TURN CFCA proposal in a rulemaking proceeding. After reviewing all of these comments, we have decided not to adopt TURN's CFCA proposal.

proposed decision. In its July 14, 1997 reply comments, the City of Palo Alto stated that after further consideration of this issue, it no longer objects to inclusion of the discounting rule as part of the Gas Accord.

In view of the above, all of the signatories to the Gas Accord have now elected to accept the discounting rule as an amendment to the Gas Accord, and, therefore, under Rule 51.7 of our Rules of Practice and Procedure, the Commission may approve the Gas Accord, as amended by the discounting rule, without addressing this matter in a separate OIR proceeding. Moreover, even opponents of the Gas Accord (such as TURN and New Mexico) have stressed the need to implement a remedy to PG&E's conflicts of interest at the time that the Gas Accord is implemented.

In view of all of these comments, we therefore find good cause for amending the Gas Accord and imposing the following discounting rule on PG&E when it implements the Gas Accord. Whenever PG&E offers any shipper (e.g., a marketer, aggregator, or end-user) a discount on its Malin to on-system path (Line 400/401), PG&E is required to contemporaneously offer a commensurate discount (i.e., penny for penny) to all shippers for similar services on its Topock to on-system path (Line 300) and its California Gas Production Path. (Hereinafter, this will be referred will be as the "commensurate discount rule"). By similar services, we mean that PG&E's offer of discounts for as-available (or interruptible) service on Line 400/401 must be matched by PG&E's offer of commensurate discounts for as-available (or interruptible) service on Line 300 and its California Gas Production Path. Similarly, if PG&E offers discounts for firm service on Line 400/401, it must offer the same discount for firm service on Line 300 and its California Gas Production Path. PG&E's offer of such discounts must take place contemporaneously, which means that PG&E may not offer or make known its intent to offer Line 400/401 discounts earlier in time than offers of discounts on Line 300 and its California Gas Production Path.

Because our finding of PG&E's conflict of interest centers on PG&E's marketing of its on-system paths, we are not at this time imposing this discounting requirement when PG&E offers discounts for its Malin to off-system (Line 401) rates.[48] It is because we have made an explicit finding that PG&E has a conflict of interest favoring its Line 400/401 service over its Line 300 service that we need to address this problem with this commensurate discount rule. However, we have not found that PG&E has a conflict of interest favoring its Line 300 service over its Line 400/401 service. Therefore, we reject without prejudice CAPP's suggestion that there should be a reciprocal condition requiring discounts of Line 400/401 rates whenever PG&E discounts Line 300 rates. However, if CAPP or any other party were to establish that PG&E has a conflict of interest favoring its Line 300 service over its Line 400/401 service, we would consider CAPP's proposed discounting requirement at that time.

We believe that this discounting rule will help mitigate PG&E's conflict of interest favoring the marketing of its Line 400/401 service over its Line 300 service. If PG&E discounts the Line 300 rate and California Gas Production Path rate when it discounts Canadian path rates, then Southwest gas and in-state production will not have to overcome the hurdle of a maximum tariff rate while Canadian gas reaches California using discounted transportation service. Discounted Line 400/401 rates might still be higher than the tariffed Line 300 rate and the California Gas Production Path rate, but the Canadian supply price advantage would allow Canadian producers gas to undercut Southwest and California gas prices at the burnertip. It would be unfair and unduly discriminatory to allow PG&E to prop up the market clearing price by refusing to discount Line 300 rates or California Gas Production Path rates while discounting its Line 400/401 rates. A fair discounting rule would be consistent with discounting practices authorized earlier in this proceeding in D.94-02-042.[49]

We conclude that imposing a discounting rule is not inconsistent with adoption of the Gas Accord and does not disturb its provisions. Discounting is mentioned in several places in the Gas Accord document,[50] but we find no explicit provision that gives PG&E unbridled discretion over

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[48] We reserve, however, the right to further consider imposing such a requirement to the extent that this Line 401 exception to the discounting rule allows PG&E or marketers to circumvent the discounting rule or it is shown that PG&E's conflict of interest affects discounts on its Line 401 rates or service.

[49] 53 CPUC2d 215, 239-240 (1994).

[50] Appendix B, pp. 7, 8, 31, 34, 47, 48.

discounting among competing services when PG&E's Line 400/401 rates are higher than its Line 300 rates, and PG&E is prohibited from providing unduly discriminatory discounts. Moreover, all signatories to the Gas Accord have now elected to accept this discounting rule as an amendment to the Gas Accord.

Both TURN and New Mexico have pointed out that PG&E could shift discounts on Line 400/401 upstream to discounts on PG&E's subsidiary, PGT, in order to circumvent this rule and to never offer discounts on Line 300 or its California Gas Production Path. As New Mexico further points out in its July 1, 1997 comments on the Assigned Commissioner Ruling and as we have found in this order, we cannot anticipate all future PG&E and market responses to PG&E's conflict of interest. Just as we did not predict backbone credit exchange agreements or the expansion shippers' numerous transactions to circumvent our crossover ban, we cannot predict how PG&E and/or marketers may attempt to circumvent the commensurate discount rule we have just adopted.

While we will not institute a rulemaking at this time and have instead imposed a discounting rule as part of this order, we agree with New Mexico that we have to continue to scrutinize PG&E's conduct and any further problems that may result from PG&E's conflicts of interest. Therefore, we are requiring PG&E to publicly file with our Energy Division on or before March 1, 1999 and serve all parties on the Gas Accord service list in A.92-12-043, et al. a market assessment report that covers pipeline system operations from the implementation date of the Gas Accord through the end of 1998. In addition to the type of information which PG&E provided in the market assessment report it previously filed herein, PG&E shall include in its market assessment report a detailed and meaningful report of each and every discount transaction (e.g., indicating level of discount, shippers, length of discount, dates of discounts, type of service) which PG&E offered and/or entered into (from the implementation date of the Gas Accord through December 31, 1998) for Line 401 rates, Line 400/401 rates, Line 300 rates and California Gas Production Path rates and which PGT, PG&E's subsidiary, offered or entered into for its rates to California and/or to the Malin delivery point.

The public disclosure of these discounts is necessary so that parties can address and we can determine whether our commensurate discount rule has been circumvented or whether our requirement is insufficient to remedy problems caused by PG&E's conflict of interest. However, we have required after the fact reporting in order to mitigate any competitive harm which could otherwise occur to PG&E from such a public disclosure.

To the extent that we were to subsequently determine after reviewing this report that the commensurate discount rule is insufficient to redress PG&E's conflict of interest and anticompetitive behavior, we could consider and impose further measures, such as broadening PG&E's commensurate discount requirement to match Line 401 rate discounts (and/or PGT's Malin delivery rate discounts) or requiring PG&E to divest Line 300 and/or its California Gas Production Path. Therefore, it could prove counterproductive for PG&E and/or others to attempt to game our commensurate discount rule and render it meaningless. Having found that PG&E has a conflict of interest and recognizing how PG&E could undermine fair competition from non-Canadian suppliers, we intend to scrutinize PG&E's discounts and take appropriate actions in the future, if necessary, in order to provide an effective remedy. We are hopeful, however, that PG&E and others will take this warning seriously and comply with both the letter and the spirit of our commensurate discount rule so that further actions on our part in this regard are not necessary.

6.5 Side Deal Payment

The side deal between Edison and PG&E, formally identified as an amendment to Edison's contract for firm Line 401 transportation service, includes a "transaction price," which is a one-time payment from Edison to PG&E. The transaction price was submitted to the Commission pursuant to the confidentiality protections of PU Code § 583, but those protections expired on May 16, 1997. The negotiated transaction price is $80 million. The ratemaking treatment of this amount by Edison and PG&E is uncertain. Should the $80 million be used to decrease PG&E's capital costs or revenue requirements? Should the $80 million be credited to its ratepayers?

We will not order any specific ratemaking treatment in this decision, but we will require PG&E to clarify its intentions by advice letter concerning Edison's payment and any other side deal payment. Any interested party may respond to PG&E's proposed ratemaking treatment, and we will thereafter decide this matter in a Commission resolution.

6.6 Distribution Discount Shortfalls

Under the Gas Accord, it is unclear whether PG&E or ratepayers will be responsible ultimately for revenue shortfalls caused by distribution discounts. PG&E's motion for adoption states, "After implementation of the Gas Accord, PG&E will no longer collect any revenue shortfalls from ratepayers and will assume 100 percent shareholder responsibility. Under the Gas Accord, PG&E will be permitted to discount transmission and distribution rates on a nondiscriminatory basis but will be at risk for any resulting revenue shortfalls."[51] Although this text appears in a section on EAD discounts, the text provides no basis from limiting its discussion to only EAD revenue shortfalls from discounts.

The Gas Accord itself states, "PG&E will have the option in BCAP proceedings of demonstrating the reasonableness of any discounted distribution contracts that will continue into the prospective period. If the Commission finds the discounts to be reasonable, PG&E will be allowed to recover the forecasted revenue shortfalls during the prospective period."[52]

We will resolve this ambiguity against PG&E. There is no ambiguity that PG&E shareholders will bear 100% of the responsibility for revenue shortfalls from transmission rate discounts. For PG&E to be "at risk" for any resulting revenue shortfalls from distribution rate discounts, it must mean, at the very minimum, that there is a strong presumption that PG&E shareholders should bear 100% of the responsibility for revenue shortfalls resulting from discounts in distribution rates. Therefore, while PG&E has an option to seek in BCAP proceedings forecasted revenue shortfalls from distribution discounts, PG&E has a very heavy burden to first demonstrate that the discount is reasonable. In addition, in light of PG&E's conflict of interest favoring its Line 400/401 transportation, we cannot foresee any situation whereby we would find distribution rate discounts reasonable in conjunction with Line 400/401 service.

7. Joint Recommendation

The full Joint Recommendation is 22 pages long and is attached to the September 24, 1996, motion for adoption filed by its sponsoring parties: DGS, New Mexico, and TURN. The Joint Recommendation is summarized in Appendix D to this decision, taken from a workshop document.

Briefly, the Joint Recommendation would: (1) retain Line 300 and Line 400 as assets in PG&E's rate base; (2) treat Line 401 as a separate, unbundled facility with its own rate base and revenue requirement; (3) reserve specific capacity amounts for core customers; (4) establish an

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[51] PG&E motion filed August 21, 1996, pp. 15-16.

IPO to manage core and UEG procurement; (5) offer noncore access to Line 400 and Line 401 at monthly posted prices; (6) offer access to Line 300 by auction; (7) credit noncore capacity brokering revenues back to noncore customers; and (8) allocate constrained receipt point capacity by price. The current crossover ban and RPCA rules would end. The new market structure would become effective January 1, 1998. The Joint Recommendation would not resolve litigation of Rule 1 allegations, Line 401 capital costs, ITCS amortization, or CPIM proposals.

According to its backers, the Joint Recommendation offers a competing vision of future gas markets in California, and would neutralize but not cure the conflict of interest inherent in the Gas Accord. It would promote competition, retain for PG&E ratepayers the economic value of original system facilities, retain incremental ratemaking for Line 401, and eliminate balancing account treatment for original system facilities assigned to the noncore. Today's Northern California gas prices are determined by Southwest gas prices; Line 300 prices under the Joint Recommendation would be lower than Line 300 prices under the Gas Accord. Although the existing record supports the concepts in the Joint Recommendation, further implementation proceedings would be required.

Parties to the Gas Accord generally oppose the Joint Recommendation. CIG and CMA together and PG&E point out that the majority of noncore end users support the Gas Accord, not the Joint Recommendation. Various parties argue that the Joint Recommendation would be a step away from unbundling, flexible service options, and secondary capacity markets. The Commission has supported these market features in past decisions. Other failings, according to Gas Accord parties, are lack of detail, rate uncertainty during upcoming years, the risk that burnertip gas prices will rise, discrimination problems under posted pricing for Line 400 and Line 401, possible confiscation of utility property inherent in capacity brokering guarantees, and the need to litigate current Commission proceedings. Amoco opposes capacity allocation by price. CCC fears the Joint Recommendation will cause problems with cogenerator parity as required by PU Code § 454.4. Enserch believes the worst feature of the Joint Recommendation is imposition of an untested market structure. Several parties characterize the Joint Recommendation as a subsidy scheme for Southwest producers and pipeline companies.

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[52] Appendix B, Paragraph III.C.8.f, p. 48.

Apache and CAPP, which did not sign the Gas Accord, argue that fully rolled-in, postage stamp gas transmission rates would resolve many market problems. Norcen, which also opposes incremental rates for Line 401, would extend the proposed IPO to operation of all PG&E transmission facilities, unless PG&E divests those assets.

The sponsors admit that the Joint Recommendation is more narrow in scope than the Gas Accord, and there are fewer supporters of the Joint Recommendation than of the Gas Accord, in part because unlike PG&E the sponsors cannot offer financial inducements to prospective partners. The sponsors claim that PG&E's conclusion that the Joint Recommendation will result in higher gas prices than the Gas Accord is misleading and implausible. They believe Line 300 auction prices would exceed Gas Accord rates only in extreme and temporary conditions. Finally, they assert that rate uncertainty should be expected in deregulated markets, and is minor relative to uncertainty in gas supply prices.

The Joint Recommendation has several appealing features. Its principal virtue is that it would allow market forces, not PG&E, to control Line 300 prices, thereby removing much of the potential for ratepayer harm associated with PG&E's conflict of interest. The Line 300 auction proposal would keep the net costs of Southwest gas low, except in periods of very high demand. This would effectively prevent the transfer of roughly $0.15/Dth in economic value from California end users to northern interests under the Gas Accord. Second, the Joint Recommendation would retain incremental ratemaking for Line 401, avoiding subsidies by original system ratepayers and the undermining of public confidence in future market tests for new capacity. Allocation of receipt point capacity by price would be a fair way to let market participants compensate the holders of valuable pipeline space. The IPO proposal is an intriguing idea. It would further reduce PG&E's conflict between shareholder and ratepayer interests, but we are not entirely comfortable with adopting it based on the current record.

We appreciate customer desires for rate certainty, but we will not criticize the Joint Recommendation for variability in market prices. As the sponsors suggest, price uncertainty often accompanies deregulation of rates. Rate certainty becomes a service attribute with market value, and customers can buy the certainty they need. In response to arguments that the Joint Recommendation market structure is untested, it seems to share that quality with the Gas Accord market structure, more or less in equal measure. Nor will we condemn the Joint Recommendation for its reduced scope compared to the Gas Accord. The record on many contested issues--the decision to construct, ITCS amortization, and conditions of service on Line 401, for example--is complete, and PEPR testimony has been served.

On the other hand, the Joint Recommendation contains two serious flaws. We agree with PG&E and its allies that the Joint Recommendation would be contrary to our preference for unbundled utility service. It would be a step backward in what we believe is a natural progression toward customer choice among flexible service options. We are also troubled by the inconsistency between auction pricing of Line 300 capacity and posted pricing for Line 400 capacity. Without expressing a preference for either approach, we are concerned that the disparity in methods could introduce unanticipated and harmful market manipulation. It is not necessary to study PG&E's arguments regarding confiscation of utility property. We can make the necessary findings regarding the Joint Recommendation without resolving that issue.

Based on the record before us, we cannot find that the Joint Recommendation is reasonable. The move away from unbundling is unacceptable and cannot be balanced against the advantages of the Joint Recommendation. The inconsistency of pricing schemes can be offset to some degree by the benefits of the Joint Recommendation, but we will not adopt it as a package.

8. ITCS and Backbone Credit Amortization

The Gas Accord was reached after development of a full record on ITCS and backbone credit amortization issues. We should review that record in order to test the reasonableness of the settlement.

In A.94-06-044, PG&E asked to amortize in rates $60.1 million of recorded and forecast costs in its ITCS account, for the period from August 1, 1993, through December 31, 1994. Amortization would have begun September 1, 1994, and the account would continue to record ITCS costs until the expiration of PG&E's contract with PGT in 2006. PG&E originally sought ex parte approval of a noncore amortization rate of $0.14/Dth, and no core rate. Four parties--CIG and CMA together, DRA, El Paso, and Palo Alto--protested the application. CIG/CMA and El Paso argued that PG&E's marketing efforts in support of Line 401 have increased ITCS charges. Palo Alto sought a reduced ITCS rate because it serves core customers. In D.94-11-024, the Commission authorized a noncore ITCS rate of $0.07/Dth, subject to refund. On February 9, 1995, ALJ Robert Barnett issued a ruling which identified disputed issues and ordered hearings to evaluate the legitimacy of costs in the ITCS account. In D.95-04-007, the Commission approved an agreement between PG&E and Palo Alto that reduces the ITCS rate for Palo Alto and the City of Coalinga. On January 29, 1996, before the scheduled hearings began, the ITCS application was consolidated with this proceeding. In Resolution G-3142, approved August 2, 1996, the Commission authorized a $0.06/Dth reduction of the noncore ITCS rate, with PG&E shareholders at risk for associated revenue shortfalls. The resolution preceded PG&E's filing of the Gas Accord, but the rate reduction is an element of a Gas Accord side deal between PG&E and CIG/CMA.

The Commission has always intended that ITCS amortization by PG&E should be subject to reasonableness review. In D.91-11-025, the Commission rejected a settlement that proposed the ITCS mechanism, but adopted capacity brokering rules based on the settlement.[53] The settlement called for amortization after Commission findings that costs were reasonably incurred. In D.94-11-024, the interim ITCS rate was made subject to refund "should the stranded ITCS costs prove to have been caused by improper acts of PG&E."[54]

In seeking to justify costs in the ITCS account, PG&E begins by arguing that ITCS obligations, which are principally El Paso demand charges for unused pipeline capacity, are sunk costs in economic terms. Therefore, they do not harm ratepayers. PG&E submits that it should be allowed full ITCS recovery because it has followed all applicable rules and guidelines in its capacity marketing activities. By setting Line 401 prices which compete with brokered interstate capacity, PG&E claims that it is taking a competitive stance in the marketplace, and that competition in general has brought billions of dollars in benefits to California consumers. The Commission has recognized that new pipeline capacity is essential to fostering gas-on-gas and pipeline-on-pipeline competition. PG&E opposes the theories of TURN and El Paso that Line 401 marketing activities have devalued brokered El Paso capacity. PG&E believes that its actions should be judged against what a reasonable manager of sufficient education, training, experience,

[53] D.91-11-025, 41 CPUC2d 668, discussion at 696, Ordering Paragraph 3 at 707, Rule F at 728 (1991).
[54] D.94-11-024, Ordering Paragraph 3, 57 CPUC2d 309, 313 (1994).

and skills would do in similar circumstances.[55] According to PG&E, its capacity brokering actions meet that standard because PG&E: (1) promoted the brokering of excess capacity in competitive markets, (2) created separate marketing teams for Line 401 and brokered capacity, (3) avoided unnecessary discounting, (4) used minimum bids responsibly, (5) negotiated prices below minimum bids in order to meet market prices, and (6) sought to maximize capacity brokering revenues. In marketing competing Line 401 capacity, PG&E claims that it has again followed Commission rules and guidelines, and has not driven Southwest competitors from the market.

In its prepared testimony, DRA recommended no disallowance of ITCS costs, but asked that the ITCS account be terminated when PG&E's contracts with El Paso expire at the end of 1997. In briefs, DRA revised its position, alleging that PG&E's conflict of interest has increased shareholder earnings at ratepayer expense. Therefore, DRA recommended disallowance of 50% of past ITCS costs and elimination of core responsibility for future costs. DRA later signed the Gas Accord, under which PG&E would bear all core ITCS costs and 50% of noncore ITCS costs.

TURN argues that core customers should be made indifferent to operation of Line 401 by adjustment of $40.1 million in 1993 and 1994 costs, separated into $13.2 million of ITCS costs and $26.9 million of unrealized capacity brokering revenues that should have been credited to PG&E's core fixed cost account. These amounts, which include core portions of Transwestern pipeline costs, should be disallowed or reassigned to the noncore. The core indifference policy should also be applied prospectively. TURN believes that ITCS costs and lost revenues are the direct result of PG&E's Line 401 marketing practices, which are driven by PG&E's conflict between shareholder and ratepayer interests.

El Paso asserts that ITCS and core capacity costs associated with Line 401 pricing practices should be allocated to the Line 401 revenue requirement. According to El Paso, PG&E's Line 401 practices, core and UEG procurement practices, and use of Transwestern capacity have caused stranded costs of approximately $101 million through May 1995. PG&E's conflicts of interest have led PG&E to favor Canadian over Southwest supplies.

New Mexico also believes that PG&E's actions have hindered the operation of a competitive market for gas in Northern California. According to New Mexico, PG&E's minimum

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[55] D.90-09-088, 37 CPUC2d 488, 499 (1990).

bids, service terms, and marketing efforts have consistently favored Line 401 over brokered Southwest capacity. New Mexico supports El Paso's determination of stranded costs, and recommends that PG&E shareholders be held responsible for all ITCS costs.

We reject PG&E's arguments that capacity brokering has no effect on ratepayers. As discussed earlier in this decision, ITCS costs are fixed, but loss of capacity brokering revenues has affected the set of all PG&E customers except the shippers that choose Line 401 capacity over brokered Southwest capacity. Such lost revenues are direct harm to captive original system ratepayers caused by PG&E's marketing practices.

We accept use of the "reasonable manager" standard in the present circumstance, but other prudence standards apply as well: (1) the utility has the burden to show with clear and convincing evidence that its operations have been reasonable and prudent; (2) the Commission has a legitimate concern with the processes employed to reach management decisions, not only with outcomes; (3) reasonableness depends on the information that managers knew or should have known; (4) utility actions should reflect the exercise of good judgment and should be expected to reach the desired result at the lowest reasonable cost consistent with good utility practices; (5) reasonable and prudent acts do not require perfect foresight or optimum outcomes, but may fall within a spectrum of possible acts consistent with utility needs, ratepayer interests, and regulatory requirements; and (6) Commission guidelines are only advisory in nature, and do not relieve the utility of its burden to show that its actions were reasonable in light of existing circumstances. Many past Commission decisions support these principles.

We find that by exercising market power in setting Line 401 prices that compete against brokered Southwest capacity, PG&E has imprudently placed shareholder interests above original system ratepayer interests. PG&E has failed the "best efforts" standard ordered by the Commission for marketing of unused interstate capacity.[56] The individual PG&E managers in charge of Line 401 sales and capacity brokering sales may have acted reasonably, but PG&E senior managers in control of both activities have relied on market power to the detriment of ratepayers, have failed to recognize the importance of PG&E's conflict of interest, and have failed

[56] D.91-11-025, Appendix B, Rules for Natural Gas Transportation and Capacity Brokering, Rule III.G.3, 41 CPUC2d 668, 724 (1991).

to resolve the conflict of interest in a reasonable manner, either by establishing a fair balance of shareholder and ratepayer priorities or by promptly bringing the conflict of interest to the Commission's attention.

When it sold Line 401 capacity, PG&E held sufficient market power to undercut Southwest prices and drive capacity brokering sales down to nearly zero. Instead, PG&E priced Line 401 to meet Southwest prices, and noncore marketers took approximately equal fractions of the available competing supplies. This rough balance shows that PG&E had market power, not that PG&E was merely a player in a competitive market. Line 401 prices met Southwest prices, not the opposite. PG&E's attention to shareholder interests is further revealed by its focus on Line 401 marketing promotions and by continued reliance on minimum bids for brokered capacity. The evidence does not rigorously prove any dependence of brokered capacity prices on minimum bids, but minimum bids otherwise serve very little purpose.

We make no attempt to weigh customer harm caused by PG&E's conflict of interest against overall competitive benefits caused by the pipeline expansion. We appreciate that increased interstate pipeline capacity and access to Canadian supplies have brought down California gas prices, but we cannot attribute specific benefits to Line 401. Those benefits could have been achieved without PG&E's ongoing conflict of interest.

After review of all the facts and arguments before us, we judge that the Gas Accord fairly resolves ITCS issues. PG&E will absorb 50% of noncore ITCS costs, less brokering credits, and 100% of core ITCS costs, less credits. These amounts are higher than the relief recommended in the ALJ's proposed decision. The record does not show whether interim rate revenues to date have recovered noncore ITCS obligations.

Turning to the backbone credit balancing account, we see a similar situation. PG&E sought rate recovery of the full amount in the account, arguing that its backbone credit transactions followed Commission rules and were reasonable. Prior to the Gas Accord, DRA and TURN recommended that PG&E be denied recovery of any backbone credit costs. They also recommended termination of new entries to the account, which we have accomplished in D.96-09-095. El Paso opposes PG&E recovery of backbone credits awarded to its UEG department, and supports rehearing of Resolution G-3122, in order to reduce the applicability of backbone credits. El Paso opposes PG&E recovery of backbone credits previously awarded to ineligible customers.

In D.96-09-095, we found that backbone credit benefits flowed to PG&E shareholders and holders of upstream pipeline capacity rather than end users, that the backbone credit partially subsidized Line 401, and that Southern California exchange agreements were contrary to the purpose of the credit.[57] We now find that in its pursuit of shareholder benefits through backbone credit transactions, PG&E again imprudently placed shareholder interests above original system ratepayer interests. PG&E senior managers exercised market power to the detriment of ratepayers, failed to recognize the importance of PG&E's conflict of interest, and failed to resolve the conflict of interest in a reasonable manner.

PG&E shareholder responsibility for 100% of backbone credit costs under the Gas Accord is a reasonable resolution of this dispute. As was true for ITCS costs, the settled amount exceeds the relief recommended in the ALJ's proposed decision. It is reasonable that foregone backbone credit amortization exceed foregone ITCS amortization because PG&E actively pursued shareholder revenues, as opposed to meeting Southwest prices when selling Line 401 capacity.

9. Rate Case Issues

In this chapter of the proposed decision, the ALJ addressed Line 401 general rate case disputes for which a record was developed before the settling parties signed the Gas Accord. Our approval of the Gas Accord obviates further consideration of these conventional rate case issues: market-based rates for as-available service; recourse rates; straight fixed variable rate options; load factor used in rate calculations; posted discount offers; revenue shortfalls caused by discounting; social and transition costs for direct connection customers; interim RPCA procedures; filing of contracts; backhaul service; and minimum bids.

10. Procedures

PG&E's motion for adoption of the Gas Accord anticipates informal workshops on tariff issues, submission of a compliance or implementation advice filing 45 days after Commission approval of the settlement, approval of the advice filing by Commission resolution, and a

[57] D.96-09-095, Findings of Fact 6, 8, and 11, at mimeo. pp. 12-13 (1996).

subsequent open season for gas transmission and distribution services.[58] We assume that informal tariff workshops have been completed or are underway. We accept PG&E's request for 45 days to prepare a tariff filing.

We leave the Line 401 general rate case open: (1) to consider A.94-05-035 and A.94-06-034, which are outstanding applications for rehearing of Resolution G-3122; and (2) to provide access to the record during the Gas Accord implementation process.

11. Proposed Decision

In compliance with PU Code § 311(d), the ALJ prepared a proposed decision in this matter. The proposed decision was mailed to all parties on March 24, 1997. Twenty-three parties filed comments, and fifteen parties filed replies to comments. The Docket Office properly rejected reply comments by the Association of Bay Area Governments because that entity is not a party to the proceeding. Pursuant to Rule 77.6(c), Assigned Commissioner Richard A. Bilas and Commissioner Josiah L. Neeper mailed an alternate proposed decision to all parties on June 11, 1997. Fifteen parties filed comments, and five parties filed replies.

After considering these comments, on June 24, 1997, Assigned Commissioner Richard A. Bilas issued a ruling regarding alternate decision which requested further comments by July 1, 1997. On July 1, 1997 eleven parties filed comments in response to the Assigned Commissioner's Ruling Regarding Alternate Decision. In addition, on July 1, 1997, the Commission's Consumer Services Division submitted its settlement with PG&E to resolve the alleged Rule 1 violations.

All of the above-mentioned comments and the Rule 1 Settlement were considered and resulted in Assigned Commissioner Richard A. Bilas and Commissioner Josiah L. Neeper mailing a revised alternate proposed decision to all parties on July 2, 1997. Seven parties thereafter filed comments, and three parties filed replies. We have considered all of these comments in rendering this decision.

The revised alternate proposed decision forms the basis for this order. In the process of approving the Gas Accord we have reviewed and carefully considered the comments of the

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[58] PG&E motion filed August 21, 1996, p. 48.

parties. We retain findings from the ALJ's proposed decision regarding market power and conflict of interest, but we have reversed his recommendation to deny approval of the settlement.

Several members of NCPA, which is a Gas Accord signatory, comment that neither the Gas Accord nor the proposed decision allow municipal electric power producers access to the same gas transportation charges as PG&E's UEG department. If adopted, this parity would give municipal utilities the same rate treatment as cogenerators. NCPA asks the Commission to rectify the omission. In a related matter, SoCalGas comments that the Gas Accord does not address transportation service priority for third party gas storage providers compared to priority for PG&E's own storage service. SoCalGas asks the Commission to make it clear that utility and non-utility storage have the same priority. We decline to adopt the recommendations of NCPA and SoCalGas. These rate parity issues are beyond the scope of the record in the Line 401 general rate case.

Findings of Fact

1. Line 401 competes directly with Southwest interstate pipelines.
2. PG&E sets prices for Line 401 as-available service based on competitive alternatives at Topock.
3. The dominant firm/competitive fringe model is a reasonable description of market dynamics at Topock.
4. Market concentration, ease of substitution for pipeline capacity, similarity of pipeline cost functions, barriers to market entry, and inelastic demand for capacity give SoCalGas and PG&E incentives to exercise price leadership at Topock.
5. Increasing gas market integration is not sufficient to prevent PG&E from exercising market power.
6. Supply basin competition and burnertip price competition do not preclude the exercise of market power in the transportation corridor between Canada and California.
7. PG&E holds market power at Topock and within California.
8. In the context of this proceeding, a conflict of interest arises when PG&E has a duty on behalf of shareholders to contend for outcomes which its duty to ratepayers requires PG&E to oppose.

9. A conflict of interest exists whenever there is a reasonable possibility that PG&E will not exercise its discretion fairly.

10. PG&E has a conflict of interest in marketing Line 401 capacity on behalf of shareholders and brokering unused Southwest capacity on behalf of ratepayers.

11. Under the Gas Accord, PG&E would have a conflict of interest in marketing its Line 400/401 capacity, as opposed to its Line 300 capacity or California Gas Production Path capacity, since PG&E could collect greater revenues from increased throughput over Line 400/401, and its subsidiary, PGT, could collect greater revenues from increased throughput in lieu of throughput on the Southwestern interstate pipelines.

12. The Gas Accord is reproduced in Appendix B to this decision.

13. The Gas Accord has several features that support its approval: (1) it has the support of a broad spectrum of active parties; (2) it would unbundle PG&E's gas transmission system into separate services, and make PG&E responsible for system revenue requirements; (3) it would resolve difficult issues in several Commission proceedings and a federal court case and provide regulatory certainty during the Gas Accord period; (4) it would divest PG&E of gas gathering facilities; (5) it would phase out PG&E's core subscription service; and (6) it would assign EAD revenue shortfalls to PG&E.

14. The Gas Accord has other features that oppose its approval: (1) it fails to resolve or mitigate PG&E's conflict between shareholder and customer interests; (2) roll-in of Line 401 rates is inefficient and contrary to incremental ratemaking principles; (3) roll-in of Line 401 rates could undermine future market tests for new capacity; (4) it provides few direct benefits for core customers; (5) it purports to settle Rule 1 allegations; (6) it does not reflect the interests of Southwest producers and pipeline companies; and (7) it holds uncertainty about disposition of Edison's side deal payment and other payments to PG&E.

15. Taken as a whole, the benefits of the Gas Accord outweigh its problems, since the Commission's approval of the Gas Accord includes a discounting rule to address PG&E's conflict of interest and the Commission's approval would not preclude future Commission proceedings addressing PG&E's conflicts of interest.

16. The Gas Accord is reasonable in light of the whole record and is in the public interest, since the Commission's approval of the Gas Accord includes a discounting rule to address

PG&E's conflict of interest and the Commission's approval would not preclude future Commission proceedings addressing PG&E's conflicts of interest.

17. PG&E may have misled the Commission and violated Commission rules by filing testimony about PG&E's reasons for constructing Line 401 which are inconsistent with the reasons given in the McLeod memo.

18. PG&E warnings to PGT shippers that PG&E might not build matching capacity in California are inconsistent with PG&E's reliance on PGT commitments to justify building Line 401.

19. Line 401 discounting limits do little to minimize stranded costs.

20. In A.89-04-033, PG&E assured the Commission that existing gas customers that did not receive service over Line 401 would be insulated from any costs or risks associated with the expansion project.

21. The meaning of PG&E's statements to the Commission is not ambiguous. No interpretation of the statements is necessary.

22. Norcen's request for findings that PG&E deceived the market into becoming captive to PG&E's designs, which were antithetical to market signals, is not supported by the evidence and should be denied.

23. Norcen's request for a Commission order requiring PG&E to accept permanent release of Norcen's contracted capacity on PGT and Canadian pipelines is not reasonable and should be denied.

24. On July 1, 1997, the Commission's Consumer Services Division submitted its settlement with PG&E concerning PG&E's alleged Rule 1 violations, which provides that PG&E would pay $850,000 and require its professional level employees appearing before the CPUC to attend an ethics training course if the Commission approved the settlement.

25. It is not necessary to defer approval of the Gas Accord in order to consider the upcoming Natural Gas Strategic Plan.

26. Approval of partially rolled-in rates for noncore customers is reasonable, only because noncore representatives have agreed to it and because the Gas Accord continues to preserve vintaged Line 400 rates for PG&E's core customers.

27. Employing a performance-based ratemaking mechanism does not remove a utility's procurement practices from the scrutiny of the Commission.

28. Disallowances or penalties for behavior favoring shareholder interests at the expense of core customer interests are not limited to those accrued under the CPIM, and are not limited to scenarios in which Southwest is the lowest cost core supply.

29. It would be unfair to allow PG&E to prop up the market clearing price for transportation into its service territory by refusing to discount Southwest to on-system service.

30. The Gas Accord does not explicitly give PG&E discretion over discounting among competing services.

31. All of the signatories to the Gas Accord have authorized representatives to state that they support or do not oppose an amendment to the Gas Accord which requires PG&E to offer commensurate discounts to shippers on Line 300 and the California Gas Production Path whenever PG&E offers discounts on its Line 400/401.

32. It is necessary for the Commission to adopt a commensurate discount rule that will mitigate the conflict between shareholder and noncore customer interests and will allow fair competition between Canadian, Southwest, and California gas supplies.

33. It is necessary for the Commission to continue its oversight over PG&E's discounting practices in order to determine whether the commensurate discount rule has been circumvented or proves to be insufficient as a remedy for PG&E's conflict of interest.

34. The ratemaking treatment of Edison's $80 million side deal payment to PG&E is uncertain under the Gas Accord and will need to be clarified and resolved after PG&E files an advice letter.

35. Regarding revenue shortfalls associated with distribution service discounts, PG&E's motion for the adoption of the Gas Accord makes clear that PG&E's shareholders should be at risk for the revenue shortfalls unless PG&E overcomes a strong presumption and establishes that the discounts were reasonable.

36. The Joint Recommendation is described in Appendix D to this decision.

37. The Joint Recommendation has three features that support its approval: (1) it would allow market forces to set Line 300 prices; (2) it would keep the net costs of Southwest gas low; and (3) it would retain incremental ratemaking for Line 401.

38. The Joint Recommendation has two features that oppose its approval: (1) it would be a step away from unbundled rates; and (2) it would set prices for Line 300 and Line 400 inconsistently.

39. Under market-based pricing of utility services, rate certainty becomes a service attribute with market value.

40. Under the Joint Recommendation, the move away from unbundled rates is not reasonable and cannot be balanced against the benefits of the agreement.

41. The Joint Recommendation is not reasonable in light of the whole record and is not in the public interest.

42. By exercising market power in setting Line 401 prices that compete against brokered Southwest capacity, and in pursuing shareholder benefits through backbone credit transactions, PG&E has imprudently placed shareholder interests above original system ratepayer interests.

43. PG&E senior managers have failed the Commission's best efforts standard for marketing of unused interstate pipeline capacity, have relied on market power to the detriment of ratepayers, have failed to recognize the importance of PG&E's conflict of interest, and have failed to resolve the conflict of interest in a reasonable manner.

44. Relief from 50% of noncore ITCS charges, 100% of core ITCS charges, and 100% of backbone credit charges under the Gas Accord is fair compensation to customers for past harm caused by PG&E's conflict of interest.

45. The requests of El Paso and the Joint Recommendation sponsors to establish an IPO should be rejected without prejudice to further consideration by the Commission.

46. El Paso's request that PG&E be ordered to divest its interstate and intrastate gas transmission facilities should be denied without prejudice.

47. Municipal utility rate parity is beyond the scope of the record in the Line 401 general rate case.

48. Transportation service priority for non-utility gas storage providers is beyond the scope of the record in the Line 401 general rate case.

Conclusions of Law

1. The record supporting this opinion was submitted for Commission decision on December 31, 1996.

2. PU Code § 1708 and the discovery of new evidence provide ample authority and justification for reopening PG&E's decision to construct Line 401.

3. Approval of the Gas Accord should be granted without precluding in any way the Commission from further considering conflict of interest, affiliate abuse, and unbundling issues in other proceedings.

4. Approval of the Gas Accord does not bind future Commissions or prohibit future Commission orders that might rescind, alter, or amend the terms of settlement.

5. PG&E should be ordered to file quarterly and annual core procurement reports after one year of operations under the Gas Accord.

6. The Commission should adopt a commensurate discount rule that will mitigate PG&E's conflict between shareholder and noncore customer interests and will allow fair competition between Canadian, Southwest, and California gas supplies.

7. Imposition of a commensurate discount rule as an amendment to the Gas Accord is authorized under Rule 51.7 of our Rules of Practice and Procedure, because the parties to the Gas Accord have accepted this amendment.

8. The Commission should continue its oversight over PG&E's conflict of interest by including a discount reporting requirement in PG&E's market assessment report which should be filed and served by March 1, 1999.

9. Approval of the Joint Recommendation should be denied.

10. Amortization of PG&E's ITCS and backbone credit accounts is subject to reasonableness review.

11. NCPA's request for municipal utility rate parity should be denied.

12. SoCalGas' request for transportation service priority for non-utility gas storage providers should be denied.

13. The Rule 1 Settlement should be granted because it is reasonable in light of the whole record, it is consistent with law, and it is in the public interest.

14. Good cause exists to waive the comment periods under Rule 51.4 of our Rules of Practice and Procedure in order to expeditiously rule on the Rule 1 Settlement since private parties, other than the alleged wrongdoers, have no right to participate in the settlement of Rule 1 violations.

15. This order should become effective today, to expedite implementation of the Gas Accord.

SIXTH INTERIM ORDER

IT IS ORDERED that:

1. The request of Norcen Energy Resources Limited (Norcen) for findings that PG&E deceived the market into becoming captive to PG&E's designs is denied.

2. The request of Norcen for a Commission order requiring PG&E to accept permanent release of Norcen's contracted capacity on Pacific Gas Transmission Company and Canadian pipelines is denied.

3. The Gas Accord is amended, with the consent of the parties to the Gas Accord, to include the following commensurate discount rule: whenever PG&E offers any shipper a discount on its Line 400/401, PG&E is required to contemporaneously offer a commensurate discount to all shippers for similar services on its Line 300 and its California Gas Production Path.

4. The requests for approval of the Gas Accord contained in Application (A.) 96-08-043 and in PG&E's August 21, 1996, motion filed in these consolidated proceedings, are granted subject to the commensurate discount rule as an amendment to the Gas Accord. The approval of the Gas Accord is based, in part, upon PG&E's representations and commitments to forego recovery of the disallowed amounts ordered by D.94-03-050 and to forego its federal district court challenge to D.94-03-050 (in N.D. Cal. Civil No. 94-4381). PG&E must implement the commensurate discount rule when it implements the other provisions of the Gas Accord.

5. The request for approval of the Rule 1 Settlement in its entirety is granted, and under Rule 87 of our Rules of Practice and Procedure we waive the comment periods of Rule 51.4 of our Rules of Practice and Procedure.

6. In its operations under the Gas Accord, PG&E shall not favor shareholder interests at the expense of core customer interests in execution of the adopted core procurement incentive mechanism, or in situations in which Southwest is the lowest cost core supply, or in interstate gas transactions with affiliated pipelines, or in dealing with affiliates or subsidiaries in general.

7. PG&E's shareholders shall bear all revenue shortfalls from future transmission rate discounts and there is a strong presumption that PG&E's shareholders should bear all revenue shortfalls from future distribution rate discounts, if any.

8. PG&E's request in A.94-06-044 to amortize in rates the amounts in its interstate transition cost surcharge (ITCS) account is granted, pursuant to the terms of the Gas Accord.

9. PG&E's request to amortize in rates the amounts in its backbone credit account is denied, pursuant to the terms of the Gas Accord.

10. Within 30 days after the completion of one year of operating experience under the Gas Accord, PG&E shall file quarterly and annual reports on core procurement operations.

11. On or before March 1, 1999, PG&E shall file with the Energy Division with service to all parties on the Gas Accord service list in A.92-12-043 et al., a market assessment report that covers pipeline system operations from the implementation date of the Gas Accord through the end of 1998. This market assessment report must include a detailed and meaningful report of PG&E's discounts for its transportation on Line 401, Line 400/401, Line 300 and the California Gas Production Path, and of PGT's discounts for its transportation to California and/or to the Malin delivery point.

12. The September 24, 1996, motion of the Department of General Services of the State of California; the Department of Energy, Minerals & Natural Resources and the State Land Office of the State of New Mexico (New Mexico); and The Utility Reform Network (TURN) for approval of their Joint Recommendation is denied.

13. The requests of TURN and El Paso Natural Gas Company (El Paso) that PG&E be denied the authority to discount Line 401 rates are denied.

14. TURN's proposal that direct connection rates include social and transition costs is denied without prejudice.

15. TURN's request to limit Line 401 backhaul service to periods when Line 300 is full is denied without prejudice.

16. The requests of El Paso and New Mexico to eliminate PG&E's use of minimum bids for brokered capacity are denied without prejudice.

17. The requests of El Paso and the Joint Recommendation sponsors to establish an independent pipeline operator are denied without prejudice.

18. El Paso's request that PG&E be ordered to divest its interstate and intrastate gas transmission facilities is denied without prejudice.

19. The request of Northern California Power Agency for orders regarding municipal utility rate parity is denied without prejudice.

20. The request of Southern California Gas Company for orders regarding transportation service priority for non-utility gas storage providers is denied without prejudice.

21. Within 45 days after the effective date of this decision, PG&E shall file revised tariff sheets as necessary to implement the above ordering paragraphs, including the commensurate discount rule.

22. The revised tariff sheets shall comply with General Order 96-A and shall apply to service rendered on or after their effective date.

23. The tariff revisions shall not become effective until after the Commission approves the advice letter filings.

This order is effective today.

Dated August 1, 1997, at San Francisco, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
RICHARD A. BILAS
Commissioners

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