Decision DRAFT DECISION OF ALJ HALLIGAN (Mailed 8/19/03)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Cost Recovery Mechanisms for Generation Procurement and Renewable Resource Development.	Rulemaking 01-10-024 (Filed October 25, 2001)

O P I N I O N

A. Summary

On April 17, 2003, San Diego Gas and Electric Company (SDG&E) filed Advice Letter (AL) 1489-E, requesting that the Commission approve its Gas Supply Plan. On page 14 of AL 1489-E, SDG&E noted that the Williams Energy Marketing and Trading Company (Williams) gas contract, which became part of the California Department of Water Resources (DWR) portfolio after the California Public Utilities Commission issued D.02-09-053, remains unallocated to a utility. SDG&E states that the allocation of the Williams Gas Contract would have a significant impact on its future Gas Supply Plans and requests that the Commission clarify the status of the Williams Gas Contract. This decision addresses SDG&E's request and adopts the allocation proposed by DWR.

B. Positions of the Parties

On June 13, 2003, Administrative Law Judge (ALJ) Julie Halligan issued a ruling requesting comments from parties regarding the Williams Gas Contract. Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE), SDG&E and DWR filed comments on July 1, 2003. PG&E, SDG&E and

SCE, collectively referred to as "the utilities," filed reply comments on July 8, 2003.

By way of background, DWR notes that it has a portfolio of contracts with various gas suppliers, which it is making available to the utilities to enable them to undertake gas procurement responsibilities as limited agents of DWR. DWR explains that the Williams Gas Contract differs from the other gas contracts in that it is a "must-take" contract for the purchase of physical gas beginning in January 2004 and continuing through December 2010. The deliveries are at southern California border delivery points and Kern River Pipeline delivery points. The contract price is fixed annually.

DWR developed a "preliminary determination" regarding the allocation of the Williams Gas Contract using the following three criteria in reaching its recommended allocation: (1) the gas should match the physical requirements of the DWR long-term power supply contracts; (2) the delivery of gas in relation to the location of the gas needs; and (3) gas utilization should be maximized.

DWR's analysis disqualifies PG&E's DWR long-term power supply contracts from eligibility for Williams gas for several reasons. DWR disqualifies PG&E's Coral contract because it becomes a tolling contract in 2006, has multiple delivery points, and is not tied to any specific power plants. DWR disqualifies PG&E's Pacificorp contract because it is from an Oregon plant (while the Williams power will be delivered in Southern California), and is based on Alberta Energy Company prices. DWR disqualifies PG&E's peaker plants because they are located north of Path 15 (NP-15) and have limited operating hours.

DWR disqualifies SCE's Sempra contract because it has multiple delivery points and it would be difficult to match the delivery location of the Williams gas to the actual physical requirements of a particular power plant. DWR disqualifies SDG&E's Sunrise contract because the Sunrise contract includes firm transportation capacity on the Kern River Pipeline and DWR believes that providing Williams gas to support this facility would effectively result in paying for transportation capacity twice and would require SDG&E to make continuous decisions regarding the use of the firm transportation capacity.

The contracts DWR included in its Williams gas allocation analysis are: Alliance, Dynegy, and High Desert for SCE, and Williams Product D and the El Cajon, Escondido and Border Calpeak contracts for SDG&E. DWR recommends allocating the Williams gas to SCE and SDG&E based on the average gas requirements for each utility over each calendar quarter. For 2004, 84% of the annual Williams gas volume would go to SCE and 16% to SDG&E, while for years 2005-2010 62% would go to SCE and 38% to SDG&E. DWR's recommendation is presented in Table 1.

SDG&E asserts that the entire Williams Gas Contract should be allocated to SDG&E. SDG&E argues that the same rationale which motivated the Commission, in Decision (D.) 03-06-068, to reject DWR's proposal to split up the Williams long-term power supply contract should come into play with respect to the Williams Gas Contract. SDG&E cites page 2 of D.03-06-068, in which the Commission states that the "proposed contract reallocation would dramatically alter the balance achieved in D.02-09-053 with respect to allocated energy, capacity, residual net short and other comparison metrics considered in that decision without clear, compensating advantages."

SDG&E also claims that its Procurement Plans for 2003 and 2004, the latter of which is now pending approval by the Commission, were developed with the assumption that the Williams gas would all be available to SDG&E. SDG&E argues that the renegotiation of the Williams long-term power supply contract (from base load to dispatchable) has left it with a large net open gas position and that removing any part of the Williams Gas Contract from its portfolio would dramatically increase its gas needs and its total portfolio risk as compared to its position prior to the contract renegotiation.

SDG&E argues that physical deliverability of the Williams gas is not essential, since the gas can easily be traded and used as a hedge. SDG&E also dismisses concerns raised by DWR that it would not be able to absorb all of the Williams gas, by stating that the Sunrise contract, which is allocated to SDG&E, would be able to absorb the Williams gas. SDG&E also claims that commercial arrangements could be made to address potential stranded costs on the Kern River Pipeline. SDG&E claims that splitting the Williams gas volumes among several parties would be complicated, and notes that none of the DWR long-term power supply contracts have been split, and no other DWR contract has its associated gas supply agreement allocated apart from its power.

PG&E maintains that the Williams Gas Contract should be allocated among all three utilities based on each utility's allocation of non-renewable DWR contracts in D.02-09-053. PG&E notes that, in contrast to the Williams long-term power supply contract, the Williams Gas Contract has never been part of any DWR contract allocation and is a new, long-term gas contract with a fixed price term that is attractive under current market conditions. PG&E also notes that, under the Commission's current methodology for allocating the cost of DWR contracts among the utilities, the costs of the Williams Gas Contract would be spread among the utilities as part of the annual DWR revenue requirement to the extent the costs are not variable costs for dispatchable power. Even with the existing cost allocation methodology, however, PG&E believes that a utility can benefit from receiving an allocation of the Williams Gas Contract because allocation of the Williams gas, or a portion thereof, can contribute to management of the utility's net open position relative to the risk tolerance limits adopted in D.02-10-062. PG&E states that all the utilities, and PG&E especially, currently have a large net open gas position and that fairness calls for sharing the benefit of the Williams Gas Contract. Moreover, PG&E notes that to the extent the gas under the Williams Gas Contract is used for dispatchable power under a DWR long-term power contract, the costs of the gas would be the responsibility of the utility allocated the DWR long-term power contract.

PG&E points out that some of the delivery points for its DWR long-term power contracts are in SP15, not just NP15, as suggested by DWR. In particular, PG&E notes that the supplier under the Coral contract can designate its deliveries to PG&E in SP15. Moreover, PG&E states, Coral becomes a tolling contract in 2006 with prices based on southern California gas prices under the generator's gas supply alternative. PG&E argues that the significant volume of Coral energy, its Southern California gas pricing provision, and the generator's right to deliver the power to SP15 support allocating a portion of the Williams Gas Contract to PG&E. Finally, PG&E points out that deliveries from Kern River pipeline would be suitable for PG&E plants.

SCE states that if the Commission intends to allocate the Williams contract, it should be done based on the utilities' respective share of the total projected DWR gas burn on a quarterly basis from 2004 to 2010. SCE recommends including PG&E in the mix, noting that the gas can be delivered to PG&E's plants, swapped with other supplies, or used as a hedge.

SCE recommends that if the CPUC decides to exclude PG&E from the contract allocation, the Williams gas should be allocated between SCE and SDG&E on a DWR contract gas burn basis. SCE also suggests that if the Williams Gas Contract volumes are allocated among the utilities, the capability to schedule gas on the Kern River pipeline should also be allocated. SCE recommends that each utility be allowed to schedule 50% of its allocated Williams gas on Kern River, and that if a utility does not schedule 50% of its allocated gas on Kern River then that utility's Kern River scheduling rights should be allocated between the other utilities on a pro rata basis. Finally, SCE recommends that, to avoid controversy, DWR should be responsible for performing all contract administrative activities and financial settlements, leaving the utilities to physically schedule the gas.

C. Discussion

DWR entered into a contract with Williams on February 16, 2001. In September 2002, the Commission issued D.02-09-053 allocating DWR's portfolio of long-term power supply contracts among the three major investor-owned utilities. The Williams long-term power supply contract was allocated to SDG&E. Subsequent to the issuance of D.02-09-053, on November 11, 2002, the Williams long-term power supply contract was renegotiated.

The renegotiation of the Williams long-term power supply contract resulted in the November 2002 Settlement Agreement which contains several new and distinct assets, including the renegotiated Williams long-term power supply contract, the Williams Gas Contract, cash consideration to be paid to the

State of California and the transfer of six combustion turbines to the Attorney General of the State of California.

The first issue we address in responding to SDG&E's request is whether or not the Commission should adopt an allocation of the Williams Gas Contract. If the Commission does not adopt an allocation of the Williams Gas Contract, the Williams volumes would remain with DWR and DWR would make those volumes available to individual utilities as it sees fit. Under this scenario, the utilities would lack the assurance necessary to incorporate the Williams' volumes into their future Gas Supply Plans. Similarly, DWR would lack the assurance that the utilities would accept the Williams gas when requested. Although the utilities are currently willing to take an allocation of the Williams gas volumes, this may not always be the case. The appeal of the Williams Gas Contract is dependent upon the market price for gas. Because DWR cannot compel the utilities to take the Williams gas volumes in the event that the price becomes unattractive, we believe that it is reasonable for the Commission to adopt an allocation of the Williams Gas Contract to provide certainty to all parties.

The next issue we address is how the Williams volumes should be allocated. SDG&E maintains that that any allocation method that does not result in allocating the entire Williams Gas Contract to SDG&E would be inconsistent with the principles adopted in D.02-09-053 and would inappropriately increase SDG&E's total portfolio risk. SDG&E also argues that splitting the Williams Gas Contract from the long-term power supply contract is similar to the splitting of the Williams long-term power supply contract that was considered and rejected by the Commission in D.03-06-068. We disagree.

While D.02-09-053 did attempt to balance, among other things, the relative allocation of must-take and dispatchable contracts among the three utilities, it did not consider the availability of DWR gas contracts to meet those contract needs. As SDG&E itself points out, the Commission has already determined that it should not reallocate the Williams Product D on the basis of the contract renegotiation. We note that the Commission made this determination despite the fact that the renegotiation of the Williams long-term power supply contract resulted in an increase in SDG&E's open gas position. Once again, the Commission made this determination without taking into consideration the availability of DWR gas contracts. Although SDG&E's open gas position would be larger if the Commission allocates part of the Williams volumes to other utilities, we are not convinced that SDG&E's total portfolio risk relative to that of the other two utilities would be inappropriately increased.

It is our understanding that the Williams Gas Contract is not intended solely to provide gas in support of the Williams long-term power supply contract. The Williams Gas Contract is a separate asset provided as part of the consideration upon which the November 2002 Settlement Agreement was reached. Furthermore, it is our understanding that the Williams Gas Contract volumes exceed the amount required for the Williams long-term power supply contract.

We agree with DWR that maximizing the use of the Williams Gas Contract to meet the needs of the DWR long-term power supply contracts is a reasonable objective. We also agree with DWR that the delivery location should bear some relation to the location of the gas needs. Unlike the DWR long-term power supply contracts that were allocated in D.02-09-053, the Williams Gas Contract will be administered by DWR. Legal title, financial reporting responsibility and responsibility for contract-related bills will remain with DWR. DWR will perform most contract administration activities and financial settlements. The utilities will only be responsible for scheduling the Williams gas volumes allocated to them. Matching the Williams gas volumes to the physical needs of the DWR long-term contracts to the extent possible will reduce the need for the utilities to develop other commercial arrangements to allow for swaps and sales of the Williams gas volumes. This will, in turn, reduce the need for the Commission or DWR to develop and administer specific accounting protocols to allocate any revenues associated with sales or swaps of the Williams gas volumes.

We find that while the allocation methodology recommended by DWR succeeds in its attempt to match the needs of the DWR long-term power supply contracts with the physical quantities of gas to be delivered under the Williams Gas Contract, the allocation methodologies proposed by PG&E and SCE do not. For the reasons stated above, we find DWR's recommended allocation reasonable.

D. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 (g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on filed by PG&E, SCE and SDG&E on September 8, 2003.

In its comments, PG&E states that the Draft Decision errs by not including the Coral Contract, which was allocated to PG&E in D.02-09-053, in the group of contracts eligible for allocation of Williams gas volumes. PG&E argues that the fact that the Coral Contract is not tied to any specific power plant does not justify excluding PG&E from an allocation of the Williams Gas Contract. For equity purposes, it would be desirable to allocate some of the Williams volumes to PG&E, however, such an allocation would be inconsistent with the goal of matching the Williams gas volumes to the physical needs of the DWR long-term contracts to the extent possible.

SDG&E's comments simply repeat its original position that the entire Williams Gas Contract must be allocated to SDG&E in order to avoid upsetting the balance of risk achieved in D.02-09-053 and in rejecting the DWR proposal to split up the Williams long term power supply contract (D.03-06-068).

In its comments, SCE requests that the Commission revise Table 1 to include a precise gas allocation per year for the period 2005-2010. SCE also requests that the Commission allocate the Kern River scheduling rights consistent with SCE's recommendation. SCE is correct that the Draft Decision did not rule on the Kern River scheduling issue. In order to maximize utilization of the Kern River scheduling rights associated with the Williams Gas Contract, the Commission should allocate the rights among the utilities. SCE's proposed allocation would fairly allocate the Kern River scheduling rights. No other party proposed a method for allocating the Kern River scheduling rights.

DWR submitted two separate responses to the Draft Decision. On August 28, 2003, DWR transmitted a memorandum to the service list providing its "final determination" concerning the allocation of the Williams Gas Contract. DWR's final determination is consistent with the allocation proposed by the Draft Decision. On September 15, 2003, DWR transmitted a second memorandum to the service list clarifying that the quarterly allocation between SCE and SDG&E provided in its August 28, 2003 memorandum was intended to be a precise allocation for each year rather than an average allocation as had been indicated in the column heading of the allocation table originally provided by DWR. Having found DWR's proposed recommendation reasonable for the reasons discussed above, we also adopt DWR's recommended clarification that the annual allocation reflected in Table 1 representing a precise allocation and not an average. This clarification will also resolve SCE's request for precision in the allocation.

E. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Julie M. Halligan is the assigned ALJ in this proceeding.

Findings of Fact

1. Allocating the Williams Gas Contract among the utilities will provide certainty to all parties regarding the future disposition of the Williams Gas Contract volumes.

2. DWR's recommended allocation of the Williams Gas Contract is consistent with the contract allocation principles adopted in D.02-09-053 and matches the physical quantities of gas to be delivered with the DWR long term power supply contracts.

3. DWR should remain responsible for administering the Williams Gas Contract.

4. The utilities should be responsible for scheduling the allocated gas volumes.

5. In order to maximize the utilization of the Williams Gas Contract, the Kern River scheduling rights under the contract should be allocated between the utilities such that each utility is allowed to schedule 50% of its allocated Williams gas on Kern River, and that if a utility does not schedule 50% of its allocated gas on Kern River then that utility's Kern River scheduling rights should be allocated between the other utilities on a pro rata basis.

Conclusions of Law

1. The Commission should allocate the Williams Gas Contract to one or more utilities to provide certainty to the utilities and DWR.

2. The Commission should allocate the Kern River Scheduling rights in a manner consistent with the allocation of the Williams Gas Contract volumes.

3. The Williams Gas Contract should be allocated to the SDG&E and SCE consistent with DWR's recommended allocation presented in Table 1.

4. In order to continue to proceed expeditiously with the utilities' Gas Supply Plans, this decision should be effective today.

O R D E R

IT IS ORDERED that:

1. The Williams Gas Contract shall be allocated to the gas supply portfolios of Southern California Edison Company and San Diego Gas and Electric Company consistent with the determination of Department of the Water Resources (DWR) as described in DWR's September 15, 2003 memorandum.

2. The Kern River scheduling rights under the Williams Gas Contract shall be allocated to the utilities such that each utility is allowed to schedule 50% of its allocated Williams Gas Contract on Kern River, and that if a utility does not schedule 50% of its allocated gas on Kern River, then that utility's Kern River scheduling rights should be allocated between the other utilities on a pro rata basis.

3. The utilities shall incorporate the Williams Gas Contracts volumes allocated to them according to today's decision into their future Gas Supply Plans beginning with the Gas Supply Plans for the period October 2003 through March 2004.

This order is effective today.

Dated ____________________________, at San Francisco, California.

TABLE 1

Quarterly Allocation of Williams Gas Contract (rounded to nearest 5 percent)	2004		2005-2010 Average (after Dynegy contract)	
	SCE	SDG&E	SCE	SDG&E
Jan - Mar	100%	0%	85%	15%
Apr - Jun	95%	5%	85%	15%
Jul - Sep	60%	40%	35%	65%
Oct - Dec	90%	10%	50%	50%

(END OF TABLE 1)