STATE OF CALIFORNIA ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

August 19, 2004 **Alternate to Agenda ID# 3743**
Ratesetting

TO: PARTIES OF RECORD IN RULEMAKING 04-01-025

Enclosed is Alternate Draft Decision of Commissioner Lynch to the Draft Decision of Administrative Law Judge (ALJ) Fukutome and ALJ Wong previously mailed to you on July 20, 2004.

When the Commission acts on this agenda item, it may adopt all or part of it as written, amend or modify it, or set aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Public Utilities Code Section 311(e) requires that an alternate to a draft decision be served on all parties, and be subject to public review and comment prior to a vote of the Commission. Rule 77.6(d) provides that comments on the alternate draft decision be filed at least seven days before the Commission meeting.

Comments on the alternate decision must be filed and served August 26, 2004. Reply comments are due August 31, 2004.

Pursuant to Rule 77.3 comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service. Please also provide an electronic copy of the comments and reply comments to Trina Horner at tah@cpuc.ca.gov.

/s/ ANGELA K. MINKIN by Phil Weismehl
Angela K. Minkin, Chief
Administrative Law Judge

ANG: epg

Enclosure

Alternate to Agenda ID #3743
Quasi-Legislative

Decision **ALTERNATE DRAFT DECISION OF COMMISSIONER LYNCH**
(Mailed 8/19/2004)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Establish Policies and Rules to Ensure Reliable, Long-Term Supplies of Natural Gas to California.	Rulemaking 04-01-025 (Filed January 22, 2004)

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OPINION ON PHASE I ISSUES

1. Summary

This decision addresses the Phase I proposals of Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Pacific Gas & Electric Company (PG&E) and Southwest Gas Company (Southwest). These proposals were filed in accordance with this Order Instituting Rulemaking (OIR) and address interstate pipeline capacity contracts, liquefied natural gas (LNG) access, and interstate pipeline access.

The OIR was opened to ensure that California does not face a natural gas shortage in the future. Through the OIR and today's decision, we further the stated goal of the Energy Action Plan to:[1]

> "Ensure that adequate, reliable, and reasonably-priced electrical power and natural gas supplies, including prudent reserves, are achieved and provided through policies, strategies, and actions that are cost-effective and environmentally sound for California's consumers and taxpayers." (Energy Action Plan, p. 2.)

The policies adopted in today's decision, which are summarized below, is part of the state's overall effort to implement and to fulfill the Energy Action Plan's goal.

1.1. Interstate Pipeline Capacity Contracts

Diversified interstate pipeline capacity portfolios, with staggered terms, maximize opportunities to benefit core customers with enhanced supply

[1] The Energy Action Plan is a joint effort by this Commission, the California Energy Commission, and the Consumer Power and Conservation Financing Authority. These three state agencies are cooperating to guide the development of California's energy future.

reliability and gas price stability. Subject to the Commission review process discussed below, we grant the utilities authority to negotiate reduced amounts of capacity and to terminate the expiring contracts with El Paso Natural Gas Company (El Paso), Transwestern Pipeline Company (Transwestern), and Gas Transmission Northwest Corporation (GTNC) in conjunction with preserving the utilities' rights of first refusal for firm capacity on these interstate pipelines.

A flexible, expeditious interstate pipeline capacity approval process will provide utilities with the opportunity to acquire core capacity in the most efficient and cost effective manner. At the same time, we must retain adequate safeguards and oversight to ensure the reasonableness of capacity acquisitions. This decision adopts capacity contract approval procedures that are modified from those proposed by the utilities to satisfy our, as well as other parties' concerns regarding regulatory oversight, including the need for formal Commission approval, the capacity planning range, the consultation/agreement process, and the degree of review in pre-approving LNG contracts.

We decline at this time to modify the existing policies governing utility acquisition of storage resources to serve core customers.

1.2. LNG Access

New gas supplies should have the opportunity to interconnect with the utility system and should be allowed to compete on an equal footing with existing supplies. PG&E, SoCalGas and SDG&E are ordered to submit, for Commission approval, non-discriminatory open access tariffs for new sources of supply.

Regarding ratemaking for LNG access, it is presumed that LNG suppliers will pay the estimated system infrastructure costs associated with their projects. However, requests for rolled-in, or any alternative ratemaking

treatment, will be allowed through the application process and addressed on a case-by-case basis. LNG suppliers will also be responsible for the costs to interconnect with the utilities' pipelines.

Due to the complexities and ratemaking implications, we will address the SoCalGas and SDG&E requests to implement its transmission system integration and firm access rights proposals in a separate application to be filed within three months of this decision.

We will initiate an evidentiary hearing process in Phase II of this proceeding to consider the cost and benefits associated with LNG, including California's long-term need for additional natural gas supplies, price effects of LNG, environmental impacts, and the effect of increasing California's dependence on foreign energy supplies. In Phase II we will also consider adoption of standardized operational balancing agreements to connect all new upstream gas pipelines that interconnect with the pipelines of SDG&E and SoCalGas, and to address the concerns raised by the parties regarding the use of a standardized operational balancing agreement.

There are a number of issues concerning LNG gas interchangeability and gas quality specifications in general. In the near future in Phase II, we will be conducting a technical workshop in coordination with other state agencies regarding the gas quality specifications.

1.3. Interstate Pipeline Access

Regarding the interconnect at Kramer Junction, some of the parties recommend that the capacity allocation method be changed, and that the distinction giving primary preference to gas flows from El Paso and Transwestern be eliminated. Today's decision does not eliminate this preference because the core customers of SoCalGas may be adversely affected. However,

SoCalGas' updated proposal to allocate receipt point capacity based on the physical capacity and expected flows of SoCalGas' North desert Transmission Zone, while preserving core supplies, is adopted.

Any further consideration of SoCalGas' peaking rate should be addressed in the Biennial Cost Allocation Proceeding (BCAP) of SoCalGas or in SoCalGas' system integration/firm access rights application.

2. Purpose of the Rulemaking

This OIR was issued in response to new reports, recent Federal Energy Regulatory Commission (FERC) orders, and ongoing changes in the natural gas market, which indicate that in the long-term, there may not be sufficient natural gas supplies and/or infrastructure to meet the future requirements of all California residential and business consumers.

In order to ensure reliable, long-term natural gas supplies to California at reasonable rates, it was determined that the Commission must make certain decisions in 2004 with regard to the California natural gas utilities that the Commission regulates, so that: (1) increased demand reduction efforts (*e.g.*, energy efficiency and renewable energy programs) help moderate the potential supply imbalance in the future; (2) sufficient firm interstate and intrastate pipeline capacity will be available to serve California; 3) the benefits and flexibility of storage facilities will be fully appreciated and utilized; and 4) access to imported natural gas supplies (*e.g.*, from LNG facilities) will be available. A number of decisions and analyses related to these issues must be made this year, due to the long lead time to construct LNG facilities and due to certain deadlines in 2004 involving the expiration of existing interstate pipeline capacity contracts. In a separate rulemaking, R.01-08-028, the Commission is addressing natural gas

energy efficiency programs and is exploring how to increase demand reduction efforts, including increasing funding for natural gas energy efficiency programs.

In this rulemaking, PG&E, SoCalGas, SDG&E and Southwest have been named as Respondents. The utilities were required to respond to data requests attached to the OIR and to submit proposals to address how California's long-term natural gas needs should be met with interstate and intrastate pipeline expansions, more flexible storage operations and access to proposed LNG facilities. The Commission invited all other interested parties to respond to the Respondents' proposals and to participate in this rulemaking.

Due to deadlines facing the utilities and/or other participants in the natural gas market, two phases were established in this rulemaking. In Phase I, the Respondents were required to address in their proposals those matters, which may require a Commission decision prior to October 2004.

The OIR ordered the Respondents to file, by February 24, 2004, Phase I proposals for rules providing guidelines for how they should:

1. enter into contracts with interstate pipelines (whether new contracts or renewals of existing contracts) to meet core supply obligations;
2. provide access on intrastate pipelines to LNG supplies; and
3. provide access to interconnecting facilities with interstate pipelines to increase California's access to natural gas supplies.

The OIR stated that Phase II would address those matters that can be decided by the end of this year and ordered the respondents to file their Phase II proposals regarding the following:

1. how the designated utilities should provide emergency reserves consisting of slack intrastate pipeline capacity, contracts for additional firm interstate pipeline

transportation rights, and supplies of natural gas in storage dedicated for emergency needs;

2. the process by which the utilities would keep the Commission informed about the infrastructure and services provided to noncore customers, and to propose a crediting mechanism in the event a noncore backstop recovery charge is adopted.

3. new ratemaking policies that will be consistent with the goal of ensuring adequate and reliable long-term supplies of natural gas at reasonable rates to California.

This decision addresses Phase I issues only.

3. Procedural History

The Commission opened this OIR on January 22, 2004. Prior to opening the OIR, the Commission, in conjunction with the California Energy Commission (CEC), hosted a two-day workshop in December 2003 entitled "Natural Gas Market Outlook 2006-2016." Various participants made presentations at the workshop about California's natural gas needs in the coming years.

In accordance with the schedule set forth in the OIR, the Phase I proposals were filed in February 2004. Phase I proposals were filed by PG&E, Southwest, Lodi Gas Storage, L.L.C. (Lodi),[2] and SDG&E and SoCalGas, the latter two filing jointly. Thirty-two comments on various aspects of the four proposals were filed.[3] This was followed by the filing of seventeen reply comments.[4]

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[2] Although Lodi was not named in the OIR as a Respondent, it submitted a proposal regarding the "value and appropriate use of in-state storage." (Lodi Proposal, p. 1.)

[3] Comments were filed by Alberta Department of Energy (Alberta), BHP Billiton LNG International Inc. (Billiton), Canadian Association of Petroleum Producers (CAPP), Coral Energy Resources LP (Coral), Crystal Energy LLC (Crystal), California Department of General Services (DGS), California Manufacturers & Technology Association (CMTA) and California Cogeneration Council (CCC), City of Palo Alto, Duke Energy Marketing America and Duke Energy North America (Duke), El Paso and

Footnote continued on next page

The scoping memo and ruling (scoping memo) for Phase I was issued by the assigned Commissioners on June 18, 2004. The scoping memo determined that no evidentiary hearings would be needed on the Phase I issues because only policy issues are to be addressed.[5] Consistent with Rule 14.1 of the Commission's Rules of Practice and Procedure, the Phase I policy determinations addressed in today's decision are based upon a review of the Phase I proposals and the numerous comments and reply comments that have been filed in this proceeding.

The scoping memo also solicited additional comments and reply comments on some supplemental LNG access issues, as discussed herein. Those comments and reply comments were filed on July 2, 2004 and July 13, 2004, respectively.

Mojave Pipeline Company (Mojave), Exxon Mobil Gas & Power Marketing Company (Exxon Mobil), GTNC, Indicated Producers, Kern River Gas Transmission Company (Kern River) and Questar Southern Trails Pipeline Company (Questar), Kinder Morgan Inc. (Kinder Morgan), Lodi , Natural Resources Defense Council (NRDC), Northern California Generation Coalition (NCGC), Occidental Energy Marketing Inc. (Occidental), the Office of Ratepayer Advocates (ORA), PG&E, Ratepayers for Affordable Clean Energy (RACE), Sempra Energy LNG Corp. (Sempra LNG), Southern California Edison Company (Edison), Southern California Generation Coalition (SCGC), SDG&E and SoCalGas, Sound Energy Solutions Inc. (SES), TransCanada Pipelines Limited (TransCanada), Transwestern, The Utility Reform Network (TURN), Watson Cogeneration Company (Watson) and Calpine Corporation (Calpine), and Wild Goose Storage Inc. (Wild Goose). Wyoming Natural Gas Pipeline Authority (WNGPA) distributed a motion to late-file its comments but did not file this motion with the Docket Office.

4 Reply Comments were filed by Billiton, Coral, CMTA and CCC, Duke, GTNC, Kern River and Questar, Lodi, ORA, PG&E, RACE, Sempra LNG, SCGC, SDG&E and SoCalGas, Transwestern, TURN, Watson and Calpine, and Wild Goose.

5 The scoping memo noted that the Commission would decide in the decision whether certain issues raised by the parties require evidentiary hearings.

4. Respondent's Proposals

Following are brief summaries of the Respondents' Phase I Proposals, which were filed on February 24, 2004.

4.1. SoCal and SDG&E

SoCalGas and SDG&E filed jointly. They recommend a diverse portfolio approach and flexibility in their ability to contract for interstate pipeline capacity for the core. They have proposed the "Interstate Pipeline Capacity Acquisition Procedure" as a means to maximize capacity acquisition opportunities with regulatory certainty. The proposal would establish a consultation process with ratepayer groups and expedited pre-approval mechanisms.

Regarding additional access to gas supplies, the utilities identified a number of LNG scenarios as well as additional interstate pipeline capacity opportunities and provided the related preliminary cost estimates. As long as certain cost benefit criteria are met, they propose to roll-in costs for infrastructure improvements related to new sources of supply. For LNG projects, rolled-in ratemaking would be capped at $200 million.

In order to facilitate access to LNG, SoCalGas and SDG&E request that new economically justified receipt points be established as needed. To facilitate access to both of the utilities' customers, they recommend that their transmission systems be integrated. Also, to provide certainty for suppliers and customers that their full gas supply needs can be delivered on any given day, the utilities have proposed that a system of tradable firm access rights be created. Such a proposal would replace the system of rights that was previously proposed and adopted in D.01-12-018, but which has not yet been implemented.

SoCalGas and SDG&E have also proposed interconnection policies that are intended to provide new suppliers with a clear understanding of their obligations, as they plan their upstream facilities.

4.2. PG&E

PG&E proposes supply planning criteria, which it claims will provide a high level of reliability at reasonable cost. Accordingly, the utility has proposed increased pipeline and storage capacities over current levels. PG&E also asserts that the process for acquiring capacity should allow sufficient flexibility to respond to changes in the market and serve as a guiding basis for long-term decisions to acquire more capacity or storage. In order to accomplish this, PG&E recommends expedited pre-approval procedures that are very similar to those contained in the SoCalGas and SDG&E Interstate Pipeline Capacity Acquisition Procedure.

PG&E proposes that project specific approval be granted prior to constructing LNG facilities. Once that is accomplished, in order to encourage the siting of LNG facilities in or near California, PG&E proposes that it, and ultimately its ratepayers, should fund the interconnection of that facility to PG&E's system. PG&E also recommends that it not be penalized if the new supply causes some existing facilities to be used less. PG&E requests that rules be established that would ensure LNG meets existing utility gas quality interchangeability requirements. PG&E also describes how it could access LNG supplies from Mexico.

In order to increase the availability of interstate pipeline capacity at Kramer Junction, PG&E recommends that, until firm access rights are established, SoCalGas should be ordered to create a process to allocate the take

away capacity between all affected pipelines based on final scheduled volumes from two days prior.

4.3. Southwest

Southwest was only required to address the sufficiency of interstate pipeline capacity to meet core procurement supply obligations. The utility indicates that its southern California needs for pipeline and storage capacity will depend on the outcome of SoCalGas restructuring. For its northern California service territory, there is only one interstate pipeline that connects directly to Southwest's distribution facilities.

Southwest requests that blanket pre-approval be granted for its acquisition of upstream resources, so long as such resource volumes are within the bounds of its core peak day requirements.

5. Comments and Reply Comments

While there may be a wide range of opinion on many aspects of the respondents' proposals, a review of the proposals, comments and reply comments indicates a general consensus that a variety of natural gas supply sources and cost effective access to those sources will benefit California ratepayers and should be encouraged by the Commission to the extent possible. Many parties advocate for a level playing field for competition to occur and to produce the best deals for ratepayers. Toward that end, parties urge the establishment of equal, non-discriminatory access to the interstate gas utility systems, as well as caution to avoid creating market advantages for specific commodity or transportation suppliers.

6. Interstate Pipeline Capacity Contract Procedures

The first Phase I issue identified in the OIR is the sufficiency of interstate pipeline capacity for core customers. Respondents were ordered to propose

rules providing guidelines for how they should enter into contracts with interstate pipelines (whether new contracts or renewals of existing contracts) to meet core supply obligations. For this purpose, Respondents were to propose the aggregate amount (on an MMcfd basis) of firm transportation rights on interstate pipelines, which it believes it should hold in 2006 under long-term contracts with interstate pipelines, as well as the aggregate amount of out-of-state supply (whether it transports the natural gas pursuant to firm contracts with interstate pipelines or purchases the natural gas at interconnecting facilities that access LNG supplies), which it believes it will need in 2016. Respondents were also asked to generally address guidelines for: how it proposes to contract for sufficient interstate pipeline capacity to meet these supply obligations without risking a supply shortage to its customers in the near future or the long-term; how it will provide supply diversity with such contracts; and what process for Commission review should take place for the Respondent to receive pre-approval of its specific contracts with each pipeline, including the potential reduction of contract demand capacity rights under existing contracts with interstate pipelines.[6]

In their initial filings, Respondents provided information on their interstate pipeline capacity needs for 2006 and the out-of-state supply needs for 2016. Also, SoCalGas proposed the Interstate Pipeline Capacity Acquisition Procedure as a regulatory oversight process that it believes balances the Commission's need to exercise oversight of large commitments of interstate

[6] In Ordering Paragraph 4 of D.02-07-037, we prohibited the California public utilities from turning back firm capacity rights on interstate pipelines unless and until we authorize such reductions in firm capacity rights on any given interstate pipeline.

capacity with the utility's need for expeditious action. Identical procedures were also proposed by SDG&E. PG&E supports SoCalGas' proposal and adopted many of the elements in its own, similar proposal. Southwest requests blanket pre-approval for storage or capacity contract acquisitions. Each Respondent's proposal is described below, followed by discussions of the issues that were identified in comments by other parties.

6.1. SoCalGas Proposal

SoCalGas' proposed Interstate Pipeline Capacity Acquisition Procedure is described in its Phase I proposal as follows:

> **Consultation and Reporting**. SoCalGas' Gas Acquisition Department will consult with ORA, the Energy Division and TURN on a monthly basis, and will provide an in-depth briefing at least quarterly. This will include, at a minimum, interstate capacity market conditions and recommendations for acquisition or disposition of interstate capacity or long-term supply contracts. All commitments for interstate capacity will be discussed with ORA, the Energy Division and TURN prior to the time a commitment is made. In addition to capacity utilization reports in the Gas Cost Incentive Mechanism (GCIM) monthly and annual reports, full details of all interstate capacity holdings, including new transactions, will be reported. These reports and briefings would be subject to the confidentiality provisions of Public Utilities Code Section 583 and General Order 66-C, and in the case of TURN, its representatives will be bound by an appropriate Non-Disclosure Agreement.
>
> **Transportation Capacity Commitment Range.** Unless otherwise directed by the Commission, SoCalGas must hold firm interstate capacity that averages an amount between 80 percent and 110 percent of the forecasted core procurement portfolio's average temperature year daily demand during non-winter months, and averages an amount between 90 percent and 120 percent of this

demand during the winter months of November through March. This requirement may be partially met by commitments for firm, long-term gas supplies from LNG or other new supply sources delivered at the California border. If SoCalGas falls below the total average capacity commitments for the winter or non-winter period of the Transportation Capacity Commitment Range, then SoCalGas will file an Advice Letter describing the circumstances and proposing a course of action to address compliance.

Authorized Capacity Commitment. After consultation with ORA, TURN, and the Energy Division, and upon ORA's approval, interstate capacity commitments within the Transportation Capacity Commitment Range shall be deemed reasonable and fully recoverable in rates in the event that any one of the following criteria is satisfied:

- Interstate capacity contracts with terms of three years or less;
- Interstate capacity contracts with terms of more than three years and quantities less than or equal to 100 MMcfd; or
- Interstate capacity contracts acquired by the exercise of Right of First Refusal (ROFR) options in response to posted bids by other shippers.

Multiple contracts with substantially similar material terms (*i.e.*, price, contract term, and receipt and delivery points) on one pipeline will be aggregated to determine compliance with the limits of the Authorized Capacity Commitment process.

Expedited Capacity Advice Letter. After consultation with ORA, TURN, and the Energy Division, and upon ORA's approval, SoCalGas will file an Expedited Capacity Advice Letter for approval of transportation capacity commitments that fall outside the limits of the Authorized Capacity Commitment process. The Expedited Capacity Advice Letter would allow ten days for protests and comments and three days for replies, and would seek

> Commission approval within 21 days. If the Commission does not act on an Expedited Capacity Advice Letter within 21 days, it shall be deemed rejected without prejudice. Renegotiated contracts with El Paso and Transwestern that initially replace the Transportation Service Agreements expiring in 2005 and 2006 will be presented by Expedited Capacity Advice Letter, regardless of amounts or contract terms, with the exception of contracts acquired by the exercise of ROFR options as stated above.
>
> **Advice Letter**. SoCalGas may elect to file an Advice Letter, pursuant to the Commission's standard procedure for Advice Letters, for approval of any transportation capacity commitment that ORA does not approve under either the Authorized Capacity Commitment procedure or Expedited Capacity Advice Letter process. Alternatively, ORA reserves the right to request that SoCalGas file an Application rather than an Advice Letter for such commitments. An Advice Letter will be filed for approval of all LNG contracts regardless of quantity and contract term. Additionally, SoCalGas may elect to file an Advice Letter requesting modifications to the Transportation Capacity Commitment Range, the Authorized Capacity Commitment procedure, and/or the Expedited Capacity Advice Letter procedure.

SoCalGas is requesting that these procedures be approved for an initial period of five years. Six months before the end of this initial period, SoCalGas would file an Advice Letter requesting the continuation or modification of these procedures.

As part of SoCalGas' proposal, it requests authorization to issue timely notices of termination for its expiring contracts with Transwestern and El Paso, and to reduce its contractual commitments on these two systems. For Transwestern, timely notice of termination is due by October 31, 2004. For El Paso, timely notice of termination is due by February 28, 2005. The request is

being made so that SoCalGas can diversify its portfolio with lower-priced supplies, and more flexible capacity contracts.

While ORA supports the procedures and planning criteria as expressed by SoCalGas, it recommends that a point be clarified and included in the proposal. In its proposal, SoCalGas suggests that ORA reserve its right to request that SoCalGas file an application only in the event that ORA does not approve SoCalGas' request under either the Authorized Capacity Commitment criteria or the Expedited Advice Letter criteria. ORA states that it also reserves the right to have SoCalGas file an application on all matters pertaining to LNG contracts and to any future changes or modifications that SoCalGas might seek with respect to these procedures. ORA indicates that, in discussions with SoCalGas, the company has accepted ORA's position on this matter and recognizes that the procedures should be modified accordingly.

SoCalGas does not dispute that it accepted ORA's clarification on this matter and recognizes that the procedures should be modified accordingly. Also, no party opposed ORA's clarification and recommendation on this matter. We find ORA's clarification to be reasonable and will include it in the adopted contract approval procedures.

6.2. SDG&E Proposal

SDG&E proposed an almost identical procedure, differing only in that TURN would not participate in the consultation process and that the interstate capacity contracts with terms of more than three years would be deemed reasonable if the quantity is less than or equal to 20 MMcfd as compared to less than or equal to 100 MMcfd for SoCalGas.

6.3. PG&E Proposal

PG&E embraces the concept of a contract pre-approval process and patterns its core gas acquisition recommendation on that of SoCalGas, with certain exceptions. First, SoCalGas' proposal is for pre-approval of interstate pipeline commitments, while PG&E has included intrastate, LNG and storage contracts. Second, PG&E rejects the necessity of specific ORA approval in the pre-approval and expedited advice letter processes. PG&E describes its Phase I proposal as follows:

> **Core Planning Standard**. PG&E proposes that its Core Planning Standard should be flexible enough to accommodate a variety of capacity and supply contracts, including not only pipeline transportation capacity, but also storage and potentially LNG. PG&E proposes holding firm transportation, storage or LNG capacity to meet a 1-in-10 year peak day and a 1-in-10 year winter load.
>
> **Pre-approved Capacity Range.** PG&E proposes that the Commission develop rules providing that the utilities will be deemed in compliance with the pre-approved Capacity Range if the range is not exceeded for a cumulative period of six months in any 36-month period. If, for any reason, PG&E capacity commitments fall below or above the pre-approved Capacity Range, PG&E would file an advice letter describing the circumstances and proposing a course of action to address compliance with the standard.
>
> PG&E proposes to consult with ORA, TURN, and the Energy Division periodically regarding PG&E capacity holdings for core customers. PG&E proposes that the Commission establish clear rules providing that all capacity commitments within the Pre-approved Capacity Range described above shall be deemed reasonable and fully recoverable in rates for any of the following:
>
> - Any existing interstate, intrastate, and storage capacity;

- Individual interstate, intrastate, storage capacity, and LNG supply contracts with terms of three years or less;
- Individual interstate, intrastate, storage capacity, and LNG supply contracts with terms of more than three years and quantities less than or equal to 100MDth/day or 3 MMDth of storage; and
- Interstate, intrastate, storage capacity, or LNG supply maintained by the exercise of the ROFR options (in response to other shippers' bids) or evergreen terms.

Expedited Capacity Advice Letter. Consistent with SoCalGas' proposal for approval of interstate, intrastate, storage, and LNG capacity commitments that fall outside the terms described above, and for all capacity in excess of current holdings acquired initially to meet the standards set forth in this proceeding, PG&E will file an Expedited Capacity Advice Letter upon consultation with ORA, TURN and Energy Division. The Expedited Capacity Advice Letter procedure should allow ten days for protests and comments and three days for replies, and seek Commission approval with 21 days of the filed date. If the Commission does not act within 21 days of the filed date, the Expedited Capacity Advice Letter will be deemed disapproved without prejudice.

Other Advice Letters. After consultation with ORA, TURN and Energy Division, PG&E may file an advice letter, pursuant to the Commission's standard procedures for advice letters, to seek modifications to the Capacity Commitment Range, and to the Expedited Capacity Advice Letter procedures.

Other Actions Not Requiring Approval through the Advice Letter Process. Capacity renewals not needing additional advice letter filings should also include capacity held under evergreen provisions in addition to capacity renewed under ROFR rights.

6.4. Southwest Proposal

Southwest states that assured cost recovery should be part of meeting core resource requirements. Southwest proposes that its currently approved cost recovery practice be continued and extended to the acquisition of upstream resources that are shown to be required to meet core peak day needs. Southwest plans for a peak day based on the coldest weather in thirty years. The company also states that a process of prior submission and pre-approval would be detrimental to the most economic acquisition of the necessary resources and proposes that blanket pre-approval be granted for its acquisition of upstream resources, so long as such resources are within the bounds of its core peak day requirements.

6.5. Discussion – Supply Diversity

The SoCalGas, SDG&E and PG&E proposals reflect their intentions to develop more diversified interstate pipeline capacity portfolios. SoCalGas and SDG&E state that the expiration of the Transwestern and El Paso contracts provides the utilities and their customers with the opportunity to achieve the benefits of such portfolios by enabling the utilities to: (1) acquire capacity commitments on pipelines with mixed terms and staggered termination dates; (2) increase the ability to take advantage of market opportunities; (3) reduce exposure to reductions in service from pipelines; (4) reduce reliance on core supply from only two producing basins; and (5) increase the portfolio components from Rocky Mountain supplies and new supply sources.

We recognize that a diverse portfolio approach for the holding of interstate capacity across supply basins and interstate pipelines with staggered terms maximizes opportunities to benefit core customers with enhanced supply reliability and gas price stability. Also, there is no opposition to the

diversification concept. Therefore, we will grant SoCalGas' and SDG&E's requests for authorization to diversify their portfolios of firm interstate pipeline capacity holdings to access gas from multiple gas producing basins and to negotiate reduced amounts of capacity and to terminate their expiring contracts on the El Paso and Transwestern pipelines in conjunction with preserving their rights of first refusal (ROFR) for firm capacity on these interstate pipelines.[7] SDG&E and SoCalGas are not, however, required to include ROFR provisions in new or renegotiated contracts. For the same reasons, the granted authority will also apply to PG&E and Southwest for their contracts which expire with interstate pipelines.[8] Thus, today's decision authorizes the gas utilities to release upcoming capacity contracts that are expiring so long as they fulfill the requirements of meeting their core procurement needs as discussed in this decision. Edison is granted the same authority so that it can take advantage of opportunities to better fulfill its gas procurement needs for electric generation.

We note El Paso's comments regarding potential higher costs for Rocky Mountain gas, the uncertainty of new sources of supply such as LNG, and the potential that its pipeline capacity may not be available to California in the future if the utilities do not renew their El Paso holdings. Transwestern questions the prudence of assuming that Rocky Mountain supplies and LNG will

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[7] Ordering Paragraph 4 in D.02-07-037 states, "No California utility shall turn back capacity rights on interstate pipelines or release their capacity rights under long-term capacity release transactions unless and until the Commission subsequently authorizes such turn back of capacity or long-term releases." This restriction applied to SoCalGas, PG&E, SDG&E, Southwest and Edison.

[8] For example, PG&E's interstate pipeline contracts with El Paso, Transwestern, and GTNC will expire on various dates in 2004 through 2007.

be available as needed to meet core demands. Alberta, CAPP, TransCanada and Wyoming also submitted comments regarding the availability of gas in the areas from which they transport gas. The information and concerns of the parties should be considered in Phase II of this proceeding as well as in the utilities' acquisition decisions, and in the consultation, review and approval processes discussed later in this decision.

6.6. Discussion – Need for Contract Approval Procedures

Most parties agree with the Respondents' assertions that a clearly articulated interstate pipeline capacity approval process, which is flexible and provides for expeditious processing and appropriate regulatory oversight, is needed to provide the utilities with the opportunity to acquire core capacity in the most efficient and cost effective manner.

The concept of the contract approval procedures, as proposed by SoCalGas, SDG&E and PG&E, is reasonable. However, we, as well as other parties, have concerns regarding specific aspects of the proposals. Modifications have therefore been made and are discussed later in this decision.

Also, El Paso and Mojave recommend that, as part of the procedures, the utilities should be required to use all reasonable efforts to acquire a portfolio of contracts, with staggering terms, using existing interstate capacity that meets their supply diversity goals. Transwestern suggest that the utilities be ordered to maintain firm access to all supply basins. SCGC advocates that the utilities first be required to take released capacity from non-utility California capacity holders before acquiring new capacity. To adopt these various recommendations at this time may limit market opportunities for the core, provide preferential treatment for certain suppliers or create a disincentive for the development of new sources of supply. We see no compelling reasons for imposing in this order these

restrictions on the core's access to market opportunities and will not do so. However, in the Commission's review process, discussed below, the Commission staff can consider the alternatives available to the utilities when deciding whether or not to pre-approve their new contracts.

Because the opportunity to terminate certain existing contracts with interstate pipelines is imminent, we need to now provide the guidance and regulatory approvals necessary for the utilities to require a more balanced portfolio of interstate pipeline capacity at reasonable rates while avoiding extreme price impacts. Therefore, we believe it is appropriate and necessary to provide guidance regarding interstate pipeline capacity at this time. In proceeding now, we are not dismissing the energy efficiency concerns raised by RACE and the NRDC. Both the Commission and the utilities understand the importance of considering cost-effective energy efficiency, renewables and demand side resources as part of the overall procurement and energy supply framework. We intend to evaluate those specific issues and their impact on California's long term natural gas demand, through evidentiary hearing in Phase II of this proceeding.

As part of their proposed contract approval procedures, PG&E, SoCalGas and SDG&E have included terms for expedited treatment, which would reduce Commission review when compared to that under the current processes. In such circumstances, we must ensure that appropriate safeguards are in place to ensure that the utilities' actions are not counter to ratepayer interests. A complicating factor is the utilities' holding company structures and the associated affiliated company relationships.

Ratepayer and shareholder interests are generally at odds, and this situation is magnified when affiliated companies conduct business with the

affiliated utility. For instance, affiliated companies of SoCalGas and SDG&E include, among others, Sempra Energy International, which develops, operates and owns energy projects in international markets, including ownership of the Transportadora de Gas Natural (TGN) and Gasoducto Bajanorte pipelines in Baja California; Sempra LNG, which is developing LNG receipt terminals; Sempra Energy Resources, which acquires and develops power plants and energy infrastructure for the competitive markets; and Sempra Energy Trading, which markets and trades oil, natural gas and power.

The Sempra LNG project in Baja California can utilize the affiliated pipelines of TGN and Gasoducto Bajanorte to bring the regasified LNG to the United States. At the border, Sempra LNG then proposes to connect to the affiliated pipeline systems of SDG&E and SoCalGas.

SoCalGas and SDG&E assert that they will adhere scrupulously to the Commission's affiliate transaction rules, and we expect them to do just that. However, it is impossible to know the degree to which utilities' business decisions are colored by the relationships with their affiliates and obligations to shareholders. Therefore, while we are allowing the utilities some flexibility in contracting for storage and pipeline capacity and providing the utilities with expedited pre-approval procedures for obtaining such capacities, any capacity acquired in association with an affiliate will not be eligible for the pre-approval process, and should be brought before the commission using the advice letter or application process. Our concerns are also reflected in our modifications to the proposed pre-approval processes and capacity planning ranges, which somewhat reduce utility flexibility from what was requested.

6.7 Discussion – Pre-Approved Capacity Range/Authorized Capacity Commitment

As detailed earlier, PG&E proposes a pre-approved capacity range procedure and SoCalGas and SDG&E propose an authorized capacity commitment procedure, both of which would establish a capacity range within which capacity contracts meeting certain prescribed criteria would be deemed pre-approved without formal Commission review. For transactions that do not meet the prescribed criteria, pre-approval can be obtained through formal Commission processes such as the proposed expedited capacity advice letter process, the standard procedures for advice letters or the filing of an application.

For the most part, other parties agree with the pre-approval procedures recommended by the SoCalGas, SDG&E and PG&E. However, RACE indicates that the Commission should not renounce its responsibility and authority to review contracts negotiated by the gas utilities before approving them. Regarding new interstate pipelines, El Paso and Mojave express concern that utilities may be forced to make long-term contract commitments that impose added risk on ratepayers and recommend that the Commission explicitly review such contracts.

The concept of pre-approval provides for up front standards and eliminates the need for after the fact reasonableness reviews. However, changing the historical practice of regulatory review must be undertaken carefully. The relinquishment of the opportunity for the Commission to review utility transactions entirely (prospectively and retroactively) must be considered carefully. Under the utilities' proposals for a pre-approved range or commitment, we would be waiving the opportunity to review and authorize, either prospectively or retroactively: contracts of unrestricted length for less than 100MMcfd; contracts with unrestricted volumes, as long as the terms are for

three years or less; and contracts acquired by the exercise of right of first refusal. An undetermined, but potentially significant, amount of capacity could be acquired in this manner, with some oversight, but with no formal Commission review or authorization. We find this to be inconsistent with carrying out our duties in a careful and diligent manner. Our preference would be for all contracts to be submitted for pre-approval either through the application, advice letter or proposed expedited advice letter processes. Therefore, we will not adopt the pre-approved capacity range or authorized capacity commitment procedures, as proposed, but instead adopt the following procedure.

We recognize that there may be interstate pipeline capacity opportunities that have turnaround times that cannot be accommodated through the proposed 21 day expedited advice letter process. Since there may be economic benefits to these kinds of transactions, there should be an opportunity to consider them for the core portfolio. We also recognize that there is a disincentive for utilities to make such transactions with no pre-approval, since they may then be subject to reasonableness review and potential disallowance. Therefore, we will limit pre-approval for interstate pipeline capacity contracts under the pre-approved capacity range or authorized capacity commitment to only those transactions that cannot be accommodated under the time limits of the proposed expedited advice letter process, with certain additional conditions.

First of all, we will impose the condition that both the contract length limit of 3 years and the capacity amount limits (100 MMcfd for PG&E and SoCalGas, and 20 MMcfd for SDG&E) will apply to all contracts that are pre-approved under this procedure. Although this limits the utility's flexibility in the type of capacity contracts that it can obtain, this condition will help ensure that large volumes of capacity will not be automatically pre-approved.

Additionally, we will limit the aggregate capacity of the contracts pre-approved under this procedure, excluding ROFR, to 25% of the core interstate pipeline capacity portfolio. We expect the utilities not to pievemeal large contracts that would not otherwise qualify for pre-approval (i.e., contracts over 100 MMcfd), into smaller agreements in order to meet these restrictions. At this time, we will not impose any limits on the amounts of capacity that can be obtained through the ROFR as proposed by the utilities.

The second condition is the imposition of a more formal Commission approval process for reviewing these pre-approved contracts. We will delegate approval authority to the Director of the Commission's Energy Division (ED). This is consistent with ED's role in approving advice letters in general and the anticipated role in approving advice letters under the proposed expedited capacity advice letter process. The utilities must present the Director of the ED with a written request for approval of the contracts which meet the pre-approval criteria, with justification for the urgency of the transaction, the date needed for ED approval, as well as evidence of the agreement of other specified parties, as discussed below. The Director of the ED should, by the date specified, indicate approval or disapproval to the utility by letter, facsimile, or electronic mail.

Finally, we limit this pre-approval process to those contracts and agreements that are not executed with the requesting utilities' affiliates. Gas supply and transportation arrangements with affiliates must use the advice letter or application process described below.

While these conditions limit potential transactions when compared to the utilities' proposals, we feel this process more reasonably balances the additional flexibility and certainty that the utilities are receiving with our regulatory responsibilities.

6.8. Discussion – Expedited Capacity Advice Letters

SoCalGas, SDG&E and PG&E have proposed an expedited advice letter process that would apply to certain transactions that do not meet the criteria for the pre-approved capacity range or authorized capacity commitment procedures. The maximum 21-day expedited capacity advice letter process includes 10 days for parties to file protests. Although this limits the amount of time for other parties to analyze and respond to the proposed transactions, no party objected to this particular aspect. Also, to lengthen the comment period might subject more contract pre-approvals to the pre-approved capacity range or authorized capacity commitment procedures, where there is no opportunity for protests. The expedited capacity advice letter procedures are reasonable and will be adopted for transactions meeting the expedited advice letter criteria as proposed by the utilities and as changed by this decision.

6.9. Discussion – Approval by Other Parties for Expedited Processes

In adopting and implementing expedited approval procedures, we find it necessary also to adopt an appropriate review process to ensure that any movement, within or outside of the approved capacity planning ranges is consistent with the best interests of core customers.

SoCalGas, SDG&E and PG&E propose a consultation and agreement process with ORA, TURN and ED. SoCalGas and SDG&E propose that ORA's agreement is necessary to move forward with either the authorized capacity commitment or expedited advice letter processes, while PG&E indicates that agreement with ORA, TURN and ED would be necessary before moving forward on the expedited processes. In comments, there was some general concern that the Commission should not delegate its responsibility to approve contracts, and

that it would be inappropriate for ORA, as an interested party, to approve contracts on behalf of the Commission.

With the inclusion of ED approval under the pre-approved capacity range or authorized capacity commitment procedures, all capacity contracts that will be submitted for pre-approval will be subject to some form of formal Commission review. Comments regarding the need for Commission review of contracts and the delegation of approval authority to ORA are therefore moot.

However, the utilities' proposed consultation and agreement proposals have merit for the purpose of reviewing the contracts within restricted timeframes. Certainly ORA, ED and TURN are knowledgeable in these areas and can provide some assurance that utility proposals are reasonable. In core matters, which this is, both ORA and TURN provide strong advocacy viewpoints. We will not limit the review to those parties, however, we believe that the process will be more robust if we allow other interested, non-suppliers to participate in the review process. Before moving forward with expedited pre-approval processes, it would therefore be reasonable to require PG&E, SDG&E and SoCalGas to have the agreement of ORA, TURN, and any other non-supplier party that has notified the Energy Division of its intent to participate in the review process. While ED should be involved in the consultation process, its agreement, similar to that of ORA and TURN, is not necessary, since final approval or disapproval will be done by the ED.

To clarify, the agreement of ORA, TURN and other interested parties is not a substitute for Commission approval by the ED, but it is a necessary element of the expedited pre-approval processes.

If agreement among parties is not reached in the proposed expedited pre-approval processes, the SoCalGas and SDG&E recommendation that the utility can then file a regular advice letter is reasonable.

6.10. Discussion – Capacity Planning Range

Central to the proposed capacity approval processes is the capacity planning range, referred to as the Transportation Capacity Commitment Range by SoCalGas and SDG&E, and the Core Planning Standard by PG&E. It is within these ranges that the utilities propose to establish their pipeline and storage capacity portfolios for core customers. The range establishes reporting requirements, if its limits are exceeded, and conditions under which the pre-approval processes for incremental capacity operates. The capacity ranges that we adopt, as discussed below, should be revisited in the utilities' respective BCAPs for possible adjustments of the capacity ranges.

6.10.1. SoCalGas

SoCalGas' proposed capacity planning range is based on the forecasted core procurement portfolio's average temperature year daily demand, with capacity volumes from 80% to 110% of this average demand establishing the non-winter month range, and amounts from 90% to 120% establishing the winter month range. The forecasted demand will either be from the latest filed BCAP or the latest California Gas Report, if the BCAP forecast is more than 12 months old. SoCalGas indicates that the pipeline capacity amounts proposed in this proceeding are based on the use of current core storage levels.

While the proposal is based on an average temperature demand, the proposed ranges encompass peak conditions. SoCalGas states that the higher part of the winter range at 108% of average temperature year daily demand is equivalent to the core procurement portfolio's cold temperature year demand

forecast. SoCalGas indicates that it designs its system to provide uninterrupted services to both core and firm noncore customers during a 1-in-10 year cold day event. SoCalGas shows a 1-in-10 year cold day event to require 1234 MMcfd for the core, which is in the upper part of the proposed winter range of 944 – 1259 MMcfd. SoCalGas is not proposing any changes to its current system reliability planning criteria, which were reviewed in Investigation 00-11-002 and approved in D.02-11-073.

SoCalGas states that its proposed range of capacity holdings for core procurement customers is generally consistent with current capacity holdings allocated to the core, and is consistent with the applicable terms of the Settlement Agreement approved by the Commission in D.02-06-023 (the decision extending the SoCalGas GCIM). Both ORA and TURN, who represent core interests, agree with SoCalGas' planning criteria. However, due to our overriding concern regarding adequate interstate pipeline capacity, we will modify the proposal.

California utilities must rely upon firm transportation contracts with interstate pipelines to preserve or provide for the infrastructure required to meet their core customers' annual demand.[9] The discretion for SoCalGas to contract for interstate capacity amounts as low as 80% of the annual average daily demand, during the non-winter months and 90% during the winter months could result in less than 100% of the forecasted annual average demand being

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[9] As the FERC recently explained, when new customers acquire firm capacity, which is turned back by California utilities, the new customers are not obligated to serve California. Moreover, interstate pipelines have "no certificated obligation to serve California other than through [firm] contracts for that capacity [to California delivery points.] *See Public Utilities Commission of the State of California v. El Paso Natural Gas Company, et al.* (2004) 106 FERC ¶ 61,315 at PP 62-64.

contracted for over the year, undermining our goal of guaranteeing that there is enough infrastructure to meet California's future demand for natural gas. Additionally we believe that the cost of interstate capacity is relatively small as compared to the cost of gas in the spot market when the demand and supply balance becomes tight. Therefore, we will be more conservative than SoCalGas in setting the capacity planning range. We do this because we feel the proposals were too vast of a departure from SoCalGas' and SDG&E's historic capacity ranges, with little rationale for why relying between 10% and 20% on the spot market in certain periods would benefit ratepayers or give the utilities an advantage in obtaining a least cost supply for the ratepayers. Given this, we will set the minimum at the annual average daily amount and the maximum at 120% of the annual average daily amount, for both the winter and non-winter months. This modification assures that core customers average annual demand is contracted for on interstate pipelines, which the Commission believes is appropriate policy. Based on SoCalGas' forecasted average temperature year daily demand of 1049 MMcfd, the range for 2006 would be 1049 MMcfd – 1258 MMcfd. In authorizing a range, we expect the utilities to efficiently manage their respective interstate pipeline capacity needs and costs during both the peak and off-peak periods.[10]

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[10] This means that SDG&E and SoCalGas shall hold on an annual average basis (April through March) a minimum of 100% and a maximum of 120% of their forecast core procurement annual average daily load. Recognizing that this is an annual average capacity range will provide the flexibility necessary to address seasonal variations in core procurement due to unpredictable weather and market conditions and help to minimize capacity in excess of short-term procurement requirements. However, this flexibility shall not be less than 90% of the forecast annual average during the spring and summer months

6.10.2. SDG&E

SDG&E's planning criteria and the related justification are identical to that of SoCalGas. For the reasons indicated above, we will apply the same transportation capacity commitment range principles to SDG&E as we do to SoCalGas. Based on SDG&E's forecasted average temperature year daily demand of 139 MMcfd, the range for 2006 would be 139 MMcfd – 167 MMcfd. SDG&E shall have until November 1, 2005 to operate within the adopted capacity range.

6.10.3. PG&E

PG&E identifies two planning standards for core firm capacity. The first is a 1-in-10 year cold peak day planning standard, which is the same that PG&E recommended in its Gas Accord II – 2004 Application (A.01-10-011), but which was not adopted. The second is a 1-in-10 year cold–winter planning standard, whereby PG&E would contract for sufficient firm storage and firm inter- and intra state pipeline capacity to meet a 1-in-10 year cold winter forecast without requiring purchases at the California border or at the city gate. PG&E states that by using the forecasted load associated with a 1-in-10 year cold winter and a 1-in-10 year peak day forecast for 2006, in combination with estimates of transmission and storage capacity costs, estimated brokering revenue from unused pipeline capacity during the summer period, and assumptions about seasonal gas price differentials, it has developed a proposed capacity portfolio that attempts to minimize cost while meeting the proposed winter planning criterion. Based on its analysis, PG&E recommends holding 43,000 MDth of in-state storage inventory and 1080 MDth/day of interstate and winter intrastate capacity in 2006. PG&E also ties its requested core capacity requirement with comparable transmission system reliability criteria, which it acknowledges is

substantially different from its current planning criteria of approximately a 1-in-3 year peak day event.

While PG&E has presented two standards, cold peak day and cold winter, it failed to firmly establish the bases for either standard or explain how they are used to determine the target capacities.

PG&E's proposal would substantially increase the amount of pipeline and storage capacity over existing levels. PG&E indicates that it currently has 33 MMDth of storage and 962 MMcfd of interstate pipeline capacity. Its proposal would elevate those amounts to 43 MMDth of storage and between 1000 and 1200 MMcfd of winter capacity. In its proposal, PG&E stated:

> "Whether the proposed level of price exposure is appropriate or not is fundamentally a question of risk preference. Ascertaining core customers' risk preferences is difficult and ultimately fraught with uncertainty. However PG&E believes that core customers tend toward a high degree of risk aversion and therefore PG&E recommends that the Commission consider a further reduction of the core's price exposure in determining the appropriate planning standard to adopt. As representatives of residential and core customers, PG&E invites [ORA and TURN] to express their views on the appropriate planning criterion." (PG&E Phase I Proposals, p. 4.)

At this time, neither ORA nor TURN support PG&E's proposed capacity planning standards. Both parties recommend that such standards be developed in PG&E's next BCAP proceeding.

We also note a difference between the SoCalGas and PG&E proposals. While peak condition events under SoCalGas' proposal are covered in the higher portion of the proposed winter capacity range, which seems

reasonable, PG&E builds its range around the peak event. Whether an additional 10% above the cold winter standard amount is necessary is not substantiated.

For the reasons stated above, we will not adopt PG&E's proposed planning standards or ranges. However, we intend to authorize a contract approval process, which requires a capacity planning range. Based on PG&E's response to the OIR's data request, its forecasted average for 2006 is 829 MMcfd. In order to determine what that range should be, if even for only an interim period until more definitive forecasts are reviewed and approved, we will set PG&E's existing interstate pipeline capacity of 962 MMcfd as the minimum amount for the range. Even though that amount is significantly more than the forecasted 2006 average daily demand of 829 MMcfd, it would be inconsistent with the goals of this OIR, if, without good reason, we were to require PG&E to hold less interstate pipeline capacity than it is already holding. We will increase this amount by 10% to establish the upper bound of the range. SoCalGas and SDG&E's upper bounds were established at 120% of the minimum, but SoCalGas' and SDG&E's minimums were established at the average daily, while PG&E's minimum is already significantly over its average daily amount. We also note that the PG&E upper bound of 1058 MMcfd is close to PG&E's estimated cold winter average daily amount of 1084 MMcfd. As with SoCalGas and SDG&E, we expect PG&E to efficiently manage its interstate pipeline capacity needs and costs within this range during both peak and off-peak periods.

Since we are essentially adopting existing interstate pipeline capacity for 2006, the associated intrastate system reliability would also approximate existing levels. PG&E estimates this to be equivalent to a 1-in-3 cold winter, which it asserts is inadequate. Increased reliability was addressed in

A.01-10-011, where PG&E proposed similar standards as it has in this OIR. In D.03-12-061, we did not adopt PG&E's proposal for a winter reliability standard for a number of reasons. One reason was that the planning and design of the size of the transmission facilities to serve customer load is an engineering issue, with significant cost implications, which requires careful review. Information to undertake such a review in this proceeding is lacking.

D.03-12-061 also noted that the current design criteria for PG&E's transmission system is to meet the more stringent of (a) core demand under abnormal peak day (APD) conditions, which is a 1-in-90 year cold temperature event, or (b) 75% of core's APD demand plus all noncore demand. PG&E needs to substantiate the need for its proposed winter reliability standard, especially considering that a system-wide diversion of PG&E's noncore customers has never been called.

There is an insufficient record to resolve PG&E's intrastate system reliability proposal in this proceeding. PG&E should subject its system reliability planning to further scrutiny by presenting its recommendations and the bases for those recommendations in a proceeding where parties have the opportunity to fully analyze the proposals and to consider the cost implications, and to hold evidentiary hearings. This should be considered in PG&E's next BCAP, or in a separate application. It would also be appropriate to consider revised capacity planning standards at that time as well.

6.10.4. Southwest

Very few comments were received on Southwest's capacity pre-approval proposal. ORA recommends that SoCalGas' proposed capacity contract procedures apply to all four utilities, including Southwest. However, ORA did not explain why SoCalGas' proposal was appropriate for Southwest,

instead of Southwest's own proposal. While the amounts of pipeline and storage capacity required by Southwest is small in comparison to the other respondents, we believe there should at least be an effort to apply the approved capacity procedure principles and policies established above, to Southwest's California operations. However, it is not clear that application of all the terms of SoCalGas' proposal is necessary for Southwest. We will direct Southwest to work with ORA to develop a proposal that meets the needs of Southwest consistent with the principles we adopt for the other respondents. The proposal can then be submitted through the advice letter process for review. Until such filing, we will maintain the current regulatory processes for Southwest.

6.11. Discussion – Storage Issues

6.11.1. Specific Inclusion of Storage

PG&E specifically includes storage in its proposed contract approval process, while SoCalGas and SDG&E do not. SoCalGas and SDG&E state that, in Phase I, they are seeking approval of a process for future core interstate capacity commitments, which is intended to be flexible and which will work in a complementary manner with the core storage program. To the extent that changes to pipeline capacity commitments affect storage commitments, those storage changes are implicitly approved in SoCalGas and SDG&E interstate pipeline capacity approval process.

Although they are apparently not contemplating any changes to core storage reservations at this time, under the SoCalGas and SDG&E proposal, such storage changes would not be subject to the proposed approval processes. Under PG&E's proposal, all incremental changes to storage commitments would be included in the approval processes. Since all parties agree that pipeline capacity and storage needs cannot be determined in isolation, PG&E's proposal

is preferable. It provides more assurance that incremental storage commitments and contracts are reasonable and have been fully considered in the context of incremental pipeline capacity. We will therefore adopt this aspect of PG&E's proposal for all three utilities. That is, any contemplated changes to core storage shall be included as part of the approval process.[11]

6.11.2. Third Party Storage

Both Lodi and Wild Goose address PG&E's position that PG&E alone is authorized to provide core storage. Lodi says that the Commission should require PG&E to put any incremental storage capacity the Commission requires PG&E to hold for its core out to bid. Lodi asserts that allowing PG&E to assign an incremental 7 to 13 Bcf of firm storage capacity to the core without giving the core an opportunity to solicit bids for that capacity from third party storage providers is anticompetitive and not in the best interests of captive core customers. Wild Goose is also concerned that PG&E is trying to prevent independent storage providers from being able to compete to provide a percentage of the storage capacity within PG&E's designated capacity range.

In response, PG&E asserts that the 1993 gas storage decision (D.93-02-013) requires local distribution companies to provide storage for the core, and that independent storage providers have no such obligation. PG&E also indicates that Lodi and Wild Goose fail to acknowledge that PG&E and SoCalGas are full service gas utilities, and are obligated to provide adequate and reliable service to their own core customers.

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[11] We clarify that changes to core storage contracts will not be considered as part of the pre-approval process outlined above.

Lodi notes that the core is already indirectly using private third party storage through the use of peaking gas supply contracts from third party marketers, who use third party storage to provide this gas.

Wild Goose contends the storage decision language merely requires PG&E to build and use storage facilities as necessary to provide reliable core service, and there is nothing in the decision which prohibits placing incremental storage capacity needed by the core out to bid.

PG&E concedes that the Commission can revisit the storage decision, and adopt new policies in light of changed circumstances. However, PG&E asserts that a decision to let independent providers compete for incremental storage service to core is a major policy change, and involves significant implementation issues. PG&E recommends that such a policy change involve workshops or other proceedings before it is implemented. PG&E believes that the following list of implementation issues need to be addressed, if third party storage providers are allowed to meet the core's incremental storage capacity requirements:

- A minimum contract length commitment by the independent storage providers, so that PG&E would have sufficient lead time to develop or construct replacement capacity if the service is no longer provided by a third party;
- Impact on PG&E's existing operating, balancing and scheduling processes and necessary changes;
- Credit quality requirements for the independent storage providers;
- The responsibility of an independent storage provider to meet the same level of reliability and operating requirements through a contract as PG&E does through its tariff;

- Setting a reasonably competitive process for selection of storage services, given that utility costs and rates are open to public inspection, whereas independent storage providers have no similar requirement; and
- Assurance that any competitive process will provide for full cost recovery for PG&E's Core Procurement Department through its proposed contract pre-approval process.

We agree with PG&E that core storage is not an appropriate role for third party storage providers at this time. An overriding purpose of this OIR is to adopt policies that will ensure an adequate and reliable supply of natural gas to core customers. While Wild Goose and Lodi may be able to meet this objective, they do not have the same legal obligations to do so as California's full service utilities. As PG&E points out, significant questions remain about the role and obligations of third party storage providers. We are reluctant to adopt this proposal at this time.

6.12. Discussion – Pre-Approval of LNG Contracts

PG&E specifically includes LNG in its proposed pre-approval processes, while SoCalGas and SDG&E do not. PG&E anticipates that in the early stages of the market development, marketers of LNG supplies will be primarily interested in promoting multi-year base load type contracts. Because of the anticipated long-term nature of LNG contracts, and because contracting for significant volumes of LNG may require adjustments to the core's transport and storage portfolio, PG&E states that it is imperative that LNG contracts be subject to the same pre-approval process as the transport and storage contracts. Coral supports PG&E's proposal. However, ORA opposes PG&E's LNG treatment and supports the SoCalGas and SDG&E proposal to address LNG matters in advice letter filings, with the caveat that it also reserves the right to

request the utility to file a formal application. TURN and RACE are also opposed to the pre-approval of LNG contracts. TURN notes that the likely longer term LNG contracts are more like supply contracts rather than pipeline capacity contracts, both in terms of price and contractual provisions. RACE urges the Commission to consider the relative flexibility of LNG supplies and the possibility that they may unfairly displace domestic supplies. TURN asserts that a rulemaking concerning pipeline capacity is not the appropriate place to slip in a dramatic change in contracting for commodity supply.

The viability and costs related to interstate pipeline and storage capacity are more certain than the ongoing activities to bring LNG supplies to serve California. California has no experience in relying on LNG supplies to meet core needs. Because of the uncertainties over how the LNG markets in California will develop, the impact of LNG suppliers on natural gas prices, and the reliability of those supplies, we will require further evidence in order to evaluate these issues. We will not adopt special pre-approval or expedited approval process at this time for LNG contracts.

We also note that the use of LNG contracts in the utilities' portfolios may affect the workings of the existing gas procurement mechanisms, and may require adjustments to accommodate these kinds of contracts.

6.13. Discussion – Energy Conservation

In their comments to the Phase I proposals, NRDC and RACE raised the role that energy efficiency and renewable generation should play in reducing the demand for natural gas. In the OIR, we recognized that energy efficiency can help moderate the demand for natural gas. In addition, the Energy Action Plan proposes specific actions relating to increasing energy conservation and efficiency measures, and to increase renewable generation.

The demand for natural gas in California reflects the efforts resulting from energy efficiency. These efforts are reflected in the BCAPs of the utilities, in the California Gas Reports and should also be reflected in the utilities' data request responses and proposals in this rulemaking, which form the basis of the utilities' demand for gas.

Several efforts have been underway to address the energy efficiency and renewable energy concerns raised by some of the parties. Many of the issues concerning energy efficiency and renewable energy have been addressed by the CEC in its ongoing Integrated Energy Policy Report proceedings, and its related work on energy efficiency standards and renewable energy programs. In addition, we have addressed energy efficiency efforts in R.01-08-028 and in R.01-10-024. Most recently in R.01-08-028, through D.04-02-059, we approved funding of energy efficiency programs for a two-year period beginning in 2004. In D.04-01-050 (R.01-010-024), we adopted a framework for the electric utilities to plan for and procure the energy resources and demand-side investments that they need to ensure their customers receive reliable service at low and stable prices. We recognize that further work is needed in the area of energy efficiency.

The focus of this proceeding is to ensure that policies and rules are in place to ensure adequate long-term supplies of gas will be available to meet California's natural gas demand. We agree with RACE and NRDC that it is appropriate to evaluate the impact of energy efficiency and renewable resources on California's demand for natural gas as we establish policies for meeting that demand. As we discuss below, we address those concerns in Phase II of this proceeding.

7. Supply Access

At the outset of this LNG discussion, we point out that we are not deciding in this proceeding whether certain proposed LNG projects should be built in California, or on the West Coast. The issue of whether individual LNG projects should be built in California, in Federal waters offshore of California, or in Mexico, is or will be addressed in the applicable regulatory proceedings examining each individual project.

The OIR directed each of the Respondents, except for Southwest, to submit a proposal concerning guidelines for how natural gas supplies from LNG facilities can access each of their intrastate pipelines and distribution facilities to the extent that LNG terminals are constructed on the West Coast. The OIR also directed the Respondents to discuss the costs and terms for interconnecting to these facilities, and to discuss whether any other issues (*e.g.*, bypass or peaking rate issues) exist and how they should be resolved if a shipper receives regasified LNG.

Due to proposed LNG projects located in Baja California, Mexico, SoCalGas and SDG&E were asked to address the following issues concerning access through Otay Mesa, the shortest route connecting Baja LNG projects to southern California: the reasonable amount of expansion capacity (which shippers may be interested in utilizing) and the costs for such capacity expansion for interconnecting facilities and intrastate pipelines to facilitate this gas supply being made available to California; the costs and terms for users of these interconnecting facilities; whether there would be double receipt points (*i.e.*, SDG&E and SoCalGas) or one integrated path for such supplies; and whether any other issues (*e.g.*, bypass or peaking rate issues) exist and how they should

be resolved if an entity supplies natural gas through this route or a shipper receives natural gas through this route.

SoCalGas was also directed to propose a means for providing additional access so that Rocky Mountain gas supplies can reach California through SoCalGas' interconnecting facilities. The Respondents were also directed to address any interconnection facility issues that they believe the Commission must decide by the summer of 2004.

The responses of PG&E, SoCalGas and SDG&E are summarized below, and are followed by discussions of the issues raised in the comments.

7.1. PG&E Proposal

7.1.1. LNG Access

PG&E is primarily interested in the development of LNG facilities as a buyer of gas and as a transporter and distributor of gas. As a buyer of gas, PG&E states that LNG holds the promise of an additional supply source, which will moderate prices and create additional opportunities to enhance the diversity of supply. PG&E indicates that its core customers are likely to benefit from LNG either through the contracting for supplies, or from the freeing up of gas supplies that are displaced by LNG in other markets.

PG&E's proposal describes three LNG access scenarios: (1) connecting to Calpine's proposed LNG facility near Eureka;[12] (2) through the North Baja Pipeline to Ehrenberg then to PG&E; and (3) by SoCalGas allowing

[12] In its submittal, PG&E provided information on a LNG facility near Eureka, which was being proposed by Calpine. In March 2004, Calpine announced that it was terminating consideration of this project. Consequently, this decision does not include discussions related to this project.

nominations from a Los Angeles city gate delivery point to an off-system connection with PG&E.

PG&E states that, as a transporter of gas, it is ready to apply to the Commission for the necessary approvals to connect to any LNG facility, subject to certain proposed principles described below. PG&E states it will build the facilities necessary to transport the gas from the LNG facility (or another utility's pipeline facilities interconnected to the LNG facility) to PG&E's existing gas transmission and distribution network. PG&E states that the planning of these facilities will help ensure that the use of existing facilities are maximized.

PG&E also takes the position that because the new facilities will be built to provide additional supply assurances for PG&E's customers pursuant to Commission goals, the Commission's approval must allow these new facility costs to be fully recoverable and included in rates. According to PG&E, similar assurances were provided in D.02-07-037 where the Commission stated that new interstate pipeline capacity acquired on the El Paso system in compliance with the decision would be found reasonable and recoverable in rates.

PG&E's proposed policy on building Commission authorized connections to new LNG facilities differs from PG&E's current interconnection policy, which requires interstate pipelines and third-party storage providers to build their own facilities to PG&E's system and pay PG&E for its costs to build the interconnect and to make nomination system changes. PG&E believes that such a policy change is warranted if the Commission wants to encourage the siting of LNG facilities in or near California.

PG&E proposes that the approval process for each LNG connection and associated PG&E downstream facilities should allow for a dialogue among interested parties on the needed facilities, costs, economic feasibility, demand for

the project, potential changes in the utilization of existing pipeline facilities, rate impacts, and gas quality interchangeability issues. If the Commission decides that an LNG project fails to provide benefits sufficient to outweigh the financial risks, PG&E would not build the connecting pipeline. In such a case, in order for the project to go forward, the LNG facility developer would need to build its own facilities or else pay PG&E to construct the necessary facilities to the nearest interconnect point on the existing transmission system. PG&E does not suggest that the Commission assert authority over whether the LNG project should be built, but states that the Commission does have authority over whether a California jurisdictional utility's gas transmission assets should be built and included in rates.

It is PG&E's position that, since the purpose of the proceeding is to provide assurance that California gas users will continue to have reliable, competitively priced gas supplies, the utilities should not be penalized if some pipeline facilities are not fully utilized because of a substantial change in flow patterns on the system after LNG facilities are built. If throughput on an existing pipeline goes down as a result of new supplies coming from another source at a different point on the system, PG&E proposes that its rates be adjusted so it continues to fully recover the cost of the existing facilities.

PG&E states that the utility should work cooperatively with the LNG supplier and its customers to ensure that the delivered gas is in compliance with the receiving utility's gas quality interchangeability requirements. PG&E proposes that the Commission enact rules requiring all LNG suppliers to process their gas to meet existing utility gas quality interchangeability requirements.

7.1.2. Access on Interconnecting Facilities with Interstate Pipelines

PG&E also addressed access to Kern River's pipeline expansion that was completed in 2003. The expansion can provide up to 900 MMcfd of new Rocky Mountain gas supplies to flow into California. PG&E states that Kern River also connects to SoCalGas at Wheeler Ridge and at Kramer Junction, but the intrastate capacity made available by SoCalGas to Kern River shippers has proven to be inadequate.

According to PG&E, SoCalGas expanded the Wheeler Ridge interconnect by 80 MMcfd and installed the new Kramer Junction interconnect. The new Kramer Junction interconnect was sized to allow 500 MMcfd of flows from Kern River to SoCalGas. But SoCalGas has only made 200 MMcfd of the 500 MMcfd available for scheduling. The remaining 300 MMcfd is not available because SoCalGas believes shippers on the Transwestern system and El Paso system have grandfathered rights to this capacity. As a result, PG&E states that a significant amount of capacity on the SoCalGas system went unused at Kramer Junction, while the Wheeler Ridge interconnect was constrained for most of the summer of 2003. Since gas from the PG&E system to SoCalGas must also go through Wheeler Ridge, PG&E states that this constraint consistently reduced off-system flows on the PG&E system from June through October 2003.

It is PG&E's position that SoCalGas should not continue to favor shippers on the Transwestern and El Paso system over shippers on the Kern River system. PG&E proposes that until SoCalGas implements a system of firm capacity rights, SoCalGas should implement a process to allocate the take away capacity between all the affected pipelines based on final scheduled volumes from two days prior. This is the same process that is used to allocate the available take away capacity at Wheeler Ridge between PG&E, Kern River,

and deliveries from Elk Hills. PG&E urges that its proposal be implemented immediately.

7.2. SoCalGas and SDG&E Proposals

In its proposals, SoCalGas and SDG&E addressed a number of issues associated with providing access to their systems to accommodate both existing and new sources of supply. These include: (1) access options, capacities and costs; (2) ratemaking issues; (3) transmission system integration; (4) firm access rights; and (5) interconnection policies.

7.2.1. Access Options

SoCalGas states that in A.02-12-027 and A.03-09-008, it demonstrated that it has sufficient slack capacity on its backbone transmission system to meet demand through 2020. The magnitude of intrastate facility expansion costs depends largely on the interconnect location of the new or expanded supply source, the size of the new or expanded source, and whether the source is allowed to displace existing supply sources such that the total 3875 MMcfd firm receipt point and redelivery capacity remains the same, or whether the new or expanded interconnect location is allowed to increase the firm receipt point and redelivery capacity of the entire system. The costs that SoCalGas and SDG&E provided in this proceeding are factored estimates, and do not represent detailed construction estimates.

In responding to the OIR's direction that it address the costs of capacity expansion for interconnecting facilities and intrastate pipelines to facilitate LNG supply availability to California at Otay Mesa or at any receipt point in or near the utilities' service territory, SoCalGas and SDG&E examined three locations on their gas transmission system for the receipt of LNG supplies. These are: Otay Mesa meter station on the SDG&E system near the US/Mexico

border (potential access by Sempra LNG and Coral); Salt Works Station on the SoCalGas system near Long Beach (potential access by SES); and Center Road Station on the SoCalGas system near Oxnard (potential access by Billiton and Crystal). On a displacement basis, new supplies would have to compete for existing pipeline delivery capacity and potentially displace current supplies, *i.e.*, the SoCalGas system firm receipt and redelivery capacity would remain at 3875 MMcfd. On an expansion basis, the SoCalGas system firm receipt and redelivery capacity would be expanded beyond 3875 MMcfd to accommodate the new supply without displacing the receipt of current supplies.

A number of access cost estimates were provided depending on location, capacity, whether it was on a displacement or expansion basis, and whether it was on a single or multiple receipt basis. The table below illustrates costs related to the potential scenarios:

		Improvement Cost ($ millions)	
Scenario	Location (Capacity)	Displacement	Expansion
1	Otay Mesa (600 MMCFD)	$76	$206
2	Salt Works Station (800 MMCFD)	5	70
3	Center Road Station (800 MMCFD)	1	11
4	Multiple Receipt (1 and 2)	85	410
5	Multiple Receipt (1 and 3)	77	220
6	Multiple Receipt (2 and 3)	6	174

As shown above and explained in the proposal, improvement costs to accommodate an expansion of the system receipt and redelivery capacity can be significant when compared to improvement costs that assume displacement of capacity.

The OIR also directed SoCalGas to file a proposal for providing additional access for Rocky Mountain supplies to reach California through interconnecting facilities. In A.02-12-027 and A.03-09-008, SoCalGas addressed the facility improvements needed to provide an expansion of 200 MMcfd of additional takeaway capacity at any one of the existing interstate receipt points. As shown in its proposal, a 200 MMcfd expansion would cost $153 million at Topock; $20 million at Blythe; $100 million at Needles; $62 million at Kramer Junction and $100 million at Wheeler Ridge. Any one of these improvements would expand the SoCalGas system receipt and redelivery capacity to 4075 MMcfd. SoCalGas notes that the indicated costs for each

location would likely be higher, if more than one of these receipt points is expanded.

In A.03-06-040 it was noted that there is an additional interconnect capacity of 300 MMcfd with the Kern River pipeline at Kramer Junction in existence today. However, that capacity competes for access to the SoCalGas transmission system with existing supplies delivered by El Paso and Transwestern. Thus it is only available on a displacement basis. In order for 200 MMcfd to be accepted and redelivered without displacing other supplies, the $62 million in facility improvements described above are required. The utilities note that their firm access rights proposal would permit an additional 300 MMcfd of supplies to be accepted and redelivered from Kern River on a firm basis in competition with other firm "north desert" deliveries.

7.2.2. Ratemaking

SoCalGas and SDG&E believe there is sufficient total receipt point "slack" capacity in place to serve expected load growth in southern California through 2016. From the perspective of a supply/demand analysis, they believe that adding to the total amount of intrastate transmission capacity during the time horizon to 2016 would be of minimal benefit. However, they believe that investments that provide access to more diversified gas supply sources will be of significant economic benefit to their customers. For example, a new supply source would: (1) increase the reliability of gas supplies in southern California; (2) increase the flexibility of customers' gas procurement by adding another supply option; and (3) increase gas-on-gas competition, creating lower burner-tip prices than would otherwise exist for all customers.

Because of these benefits from supply diversity, SDG&E and SoCalGas recommend that the Commission adopt a policy supporting diversity

of supply sources. Specifically, SDG&E and SoCalGas recommend that the following policy statement be adopted:

> "It is in the interest of California that new sources of gas supply be encouraged. Therefore, to the extent that the benefits to all utility customers of access to the new gas supplies are greater than the cost to utility customers, the costs of expanding utility backbone facilities necessary to accommodate new gas supplies should be rolled-in to the utilities' system wide transportation rate. Below a certain cost threshold, it should be presumed that benefits exceed cost." (SDG&E and SoCalGas, Phase I Proposal, pp. 69-70.)

SoCalGas and SDG&E state that this policy statement is consistent with the Energy Action Plan's direction on new supply sources and is consistent with FERC policy on rolled-in ratemaking.

In conjunction with this policy statement, SoCalGas and SDG&E propose that if customers express an interest in new or diversified supply sources, SDG&E and SoCalGas would roll-in new or expanded supply access infrastructure costs up to $100,000 per MMcfd of added supply capacity, with a maximum cost for all projects of $200 million. SoCalGas and SDG&E note that the $200 million figure represents a minimum of 2 Bcfd of added receipt capacity at a cost to customers of less than 4 cents per Mcf, or less than one percent of the expected total delivered cost of gas.

The proposed roll-in criteria are based on the price benefits of a more diversified set of supply sources. SoCalGas and SDG&E conducted an analysis of price changes under different demand and basin price scenarios, and investigated the effects of adding a new source of supply to southern California. They assert that a new supply source is a benefit to customers because it creates another option for customers and additional competition to other sources of

natural gas supplies. When the new supply source becomes a competitive option to supplies from an expensive basin, there is value to all customers in reduced California border prices. The larger the new supply addition, the greater the opportunity to replace gas supplies from more expensive supply sources and the greater the associated price benefits for all customers.

Since LNG is a new supply source, and based on the diversity benefit analysis, SoCalGas and SDG&E propose to apply the rolled-in ratemaking treatment to LNG projects. They also propose to apply the same rolled-in treatment for expanded access to gas supplies from the Rocky Mountains until the amount of access to this gas is similar to the access to the San Juan and Permian Basins. At that point, they state there would be no additional diversity benefit. While rolled-in ratemaking treatment is not currently proposed for expanded access to San Juan or Permian, the utilities state that if any party can show that the costs of expanding take-away capacity at a receipt point accessing the San Juan or Permian Basins are outweighed by customer benefits, rolled-in treatment should also be considered for such costs.

SoCalGas and SDG&E propose that the revenue requirement changes associated with the rolled-in costs be allocated on an equal cents per therm basis since the net benefits are based on expected gas commodity cost reductions. The projects are intended to provide access to another supply source which results in diversity benefits. Thus, the costs would not be accounted for in the capital dollars authorized in the SoCalGas and SDG&E cost of service proceedings. Also, the costs to be rolled-into rates would not be to meet new customer growth, so the costs would not be accounted for in the annual PBR adjustment mechanism.

SDG&E and SoCalGas propose that a rolled-in ratemaking presumption be established in this proceeding, and that the presumption remain in place until such time the Commission finds that a higher level of utility capital spending on new or diversified supply access is justified.

SDG&E and SoCalGas state they are willing to build expansion or displacement capacity for access to new supplies beyond the capacity that meets the presumption for rolled-in treatment (or which could qualify for rolled-in treatment under a more extensive evidentiary process), for customers or shippers willing to make a long-term commitment to pay the costs of such facilities. As explained in the firm access rights proposal, the open season bidding would be based on a supply curve supplied by SDG&E and SoCalGas using the best estimates available for the cost of constructing added increments of capacity. The capital costs would be converted to a rate per Mcf based on similar factors used to calculate the rolled-in cost except that the costs will be amortized over 15 years.

7.2.3. Transmission System Integration

Currently, SoCalGas has a large transmission system with interconnects to PG&E and all of the interstate pipelines serving southern California. These pipelines access a diverse set of basins, including San Juan, Rocky Mountain, Canadian, and Permian supplies. SoCalGas also provides access to gas from California producers and offshore producers.

All SoCalGas and SDG&E customers schedule natural gas deliveries through the SoCalGas receipt points using SoCalGas' scheduling system. SDG&E has no on-system gas production and receives all gas supplies through interconnects with SoCalGas. The primary delivery point into the SDG&E system is at Rainbow Station in southern Riverside County. Since the merger,

the Gas Transmission/Gas Operations group has jointly operated both transmission systems. The utilities assert that this combined operation has led to greater efficiency and reliability for customers in both service territories.

As a wholesale customer of SoCalGas, SDG&E customers currently pay for the use of SoCalGas' transmission system. SoCalGas customers, excluding electric generation customers, do not utilize or pay for SDG&E's transmission system, except for a small share of the Moreno compressor station.

SoCalGas and SDG&E state that the Commission should adopt rules that promote the greatest access to new supply sources for both utility customers. They assert that the most efficient way to accomplish this is to establish an integrated, common access system. The integrated access approach would allow all utility customers in southern California to have the same priority of access, terms, and conditions for natural gas delivered at any point on these two systems.

Under the integrated access approach, SoCalGas and SDG&E customers would continue to schedule natural gas deliveries through the combined SoCalGas and SDG&E receipt points. The customers of both utilities would pay a single integrated transmission rate for delivery from any receipt point to any burner tip location in the combined service area. In addition, customers would continue to pay the separate distribution rates established by each utility for its own service territory.

SoCalGas and SDG&E state that with the development of LNG supplies in Baja California, Otay Mesa could become a significant receipt point for customers of both utilities. It is expected that regasified LNG deliveries to Otay Mesa will provide more natural gas than can be consumed within SDG&E's territory. Therefore, LNG developers are interested in full access to the SoCalGas

system and its customers and storage assets. In order to provide these LNG developers with assurance that efficient access to the SDG&E and SoCalGas markets will be available through Otay Mesa, SoCalGas and SDG&E request that the Commission allow the establishment of Otay Mesa as a common receipt point for both utilities by December 31, 2004. Once SoCalGas customers have access to new supplies at Otay Mesa, SoCalGas customers should then pay part of the cost of the SDG&E transmission system, just as SDG&E customers pay part of the SoCalGas transmission system today.

Under the utilities' proposal, the integrated transmission rate would be based on the embedded cost of the combined transmission facilities of the two utilities, including any rolled-in intrastate expansion facilities required to bring new supplies to the market centers. SoCalGas and SDG&E state that on an embedded cost basis, the integrated transmission rate will increase class average transportation rates for SoCalGas customers by 0.2 to 0.4 cents per therm, and SDG&E customers will realize a 2 to 4 cents per therm rate reduction. The Sempra wide electric generation rate will be reduced by approximately 0.2 cents per therm. The utilities propose that specific rate issues be addressed in a second phase of their BCAPs. In the interim, Otay Mesa supplies would be scheduled using SoCalGas' scheduling system, and customers would pay the approved transportation rates of their respective utility for deliveries through this new receipt point.

The utilities claim that the effect on natural gas prices as a result of access to a new supply is likely to be of much greater benefit than the small transportation rate impact on SoCalGas' customers. They also assert that the integrated access rate will establish a reasonable means for SoCalGas' customers

to pay for transportation of natural gas through the SDG&E system from Otay Mesa.

Without an integrated access approach, separate receipt points into the SDG&E and SoCalGas systems would need to be established at Otay Mesa and Rainbow Station, respectively. That is, customers in SoCalGas' service territory wanting access to Baja LNG supplies would be required to schedule deliveries through both SDG&E's Otay Mesa and SoCalGas' Rainbow receipt points. SDG&E customers and suppliers wanting access to SoCalGas storage would also be required to schedule deliveries through both receipt points. They claim that the creation of this double receipt point scenario would cause several inefficiencies including loss of operating efficiencies and the creation of artificial pricing advantages for some pipeline delivery points over others, which would distort competition.

The utilities state that if there is an integrated SoCalGas and SDG&E access point, the peaking rate will not apply to customers scheduling deliveries through Otay Mesa. The peaking rate was established to address the pricing and service provisions for customers who partially bypass the SoCalGas system, but remain connected to SoCalGas for their peaking needs. According to the utilities, with transmission integration, customers on both SoCalGas and SDG&E who ship gas through Otay Mesa would not be partially bypassing the utilities' transmission system and the peaking rate would not apply.

However, SoCalGas and SDG&E state that SoCalGas' peaking rate will apply to a partial bypass customer who takes service from an LNG supplier and takes partial service from the utility. If an LNG customer base loads on the LNG supplier and uses the SoCalGas system to meet their peak needs, that customer imposes the same cost on the SoCalGas system as an interstate pipeline

customer taking peaking service from SoCalGas. SoCalGas and SDG&E state that the Commission should ensure that LNG customers who choose to partially bypass the utility pay their share of the costs imposed on the utility, as reflected in SoCalGas' cost-based peaking rate.

7.2.4. Firm Access Rights

SoCalGas and SDG&E propose that a system of firm, tradable receipt point access rights be adopted. Such a system will provide assurances to developers of interstate pipeline and LNG projects that their gas supplies will be able to enter the SoCalGas system on a firm basis. The utilities request that the Commission adopt its proposed system of firm tradable access rights as soon as possible. To the extent the Commission concludes that the details associated with firm access rights require evidentiary hearings, the utilities request that the Commission consider such details in Phase II of this proceeding.

SoCalGas explains that its transmission system currently has the capability to take 3875 MMcfd of intrastate and interstate supplies from various receipt points and redeliver those supplies to storage fields and/or distribution customer end-users. This is a firm 365 day a year capability. However, the total supplies that theoretically could reach SoCalGas on a given day exceeds 6 Bcfd based on the capacity of upstream pipelines. SoCalGas claims that, under the current rules, this mismatch makes it difficult to create a reliable firm connection between a supplier and its southern California end use customer for every day of the year. The cost of expanding its receipt point take away capability to 5 Bcfd would be expensive (over $500 million), and in SoCalGas' opinion, unnecessary, because of the available slack capacity.

SoCalGas and SDG&E claim that, instead of making expensive and unnecessary capital investment in the backbone system, there should be a system

of firm tradable rights on the intrastate transmission system. A system of firm tradable rights currently exists for PG&E, and SoCalGas and SDG&E claim that a similar system needs to be developed for southern California. The utilities explain that, if ownership rights for the existing 3875 MMcfd of backbone transmission take away capacity can be established, the owners of those rights could establish a firm reliable connection between a particular supply source and the customer's burner tip. The owners of such receipt points could then switch suppliers depending on the price benefits of that supply. New customers or suppliers could bid or trade for those rights through the secondary market to ensure firm deliveries to the SoCalGas city gate.

The Comprehensive Settlement Agreement (CSA) of April 2000 tried to establish such a system. That system, however, was never implemented[13] and, according to SoCalGas and SDG&E, is outdated and deficient for the following reasons:

- First, the rights negotiated during that settlement gave preferences to existing suppliers over new suppliers.
- Second, the term of the CSA rights were limited to less than five years, while the development of new supplies often requires long term access rights.
- Third, the CSA did not provide a framework by which to add new supplies at new receipt points.
- Fourth, the CSA did not describe how SoCalGas might expand backbone transmission capacity.

[13] The CSA was adopted, but not implemented in D.01-12-018. Tariffs implementing D.01-12-018 were adopted in D.04-04-015, but that order was stayed pending a Phase I decision in this OIR.

The utilities state that, relative to the CSA framework, the new proposal should be preferable to customers because: (1) the set asides suggested for core customers look beyond SoCalGas' soon to expire El Paso and Transwestern service agreements and are consistent with the core supply diversity efforts; (2) there is a substantially lower reservation charge, and the resulting revenues are credited back to end users; (3) there is a shorter term commitment required of customers, which allows them to compete for receipt points in new open seasons based on their more recent demand and perceived changes in the values of relative receipt points; and (4) the broader and more flexible definition of receipt point rights by transmission zone will allow customers greater ability to exert downward price pressure on competing gas supplies.

SoCalGas and SDG&E also state that, relative to the CSA framework, the new proposal should be preferable to new gas suppliers because: (1) it puts new gas supplies on a level playing field with existing supplies; (2) it accommodates a variety of potential new supplies at new receipt points; (3) it permits the economic expansion of the transmission system; and (4) it allows new suppliers and/or their customers to obtain long term access to the SoCalGas system so that their large capital investments can be justified.

A four-step proposal to allocate capacity is described in detail in the Phase I proposal of SoCalGas and SDG&E. In summary, for step 1, there would be a set aside option for three years. This step would only apply to existing capacity or potential new receipt point capacity that meets the rolled-in presumption. For step 2, there will be preferential bidding by noncore customers for three years. This step would only allocate existing capacity or potential new receipt point capacity that meets the rolled-in presumption. For step 3 there

would be a long-term general auction for new capacity. For Step 4, there would be a shorter-term general auction. In this step any party would be allowed to bid. In steps 3 and 4 any party would be allowed to bid, with the maximum total bid for any party established by its creditworthiness.

SoCalGas and SDG&E also propose the following:

- Associated reservation charge revenue would be credited to all end-users on an equal cents per therm basis.
- Any unawarded firm capacity and daily interruptible capacity would be offered by the utility on a daily volumetric basis for up to 5 cents per dth, and a 75/25 ratepayer/shareholder incentive sharing mechanism would be established for these interruptible revenues.
- The utility would sell interruptible backhaul services from the city gate to any receipt point on its system. This gas could, in turn, then be delivered off system.
- SDG&E and SoCalGas would provide reports to the Commission on the ownership, use, and pricing of the intrastate capacity rights awarded through this process.
- Within a transmission zone, customers would be able to nominate daily on an alternate basis to any of the other receipt points. Alternate receipt rights nominations would be subject to SoCalGas' proposed scheduling and nomination rules.
- NAESB standards would apply for the purposes of bumping of prior scheduled volumes on a cycle-by-cycle basis. SoCalGas will schedule and confirm nominations in accordance with the following priority order: Priority 1 – all nominations utilizing Firm Capacity receipt rights; Priority 2 – all nominations designated as Alternate Receipt Points;

Priority 3 – all nominations utilizing interruptible capacity receipt rights.

- There would be no changes to its existing balancing rules in this proceeding. SoCalGas states that new balancing rules are not necessary to implement a system of firm, tradable access rights and intends to address its balancing rules in another proceeding, such as the BCAP.
- The utility would provide for city gate pooling to allow for the aggregation of multiple gas supplies being delivered from multiple receipt points. This pooling location would be on the SoCalGas system after the gas is delivered through a receipt point using the customers' access rights.
- A system-wide in kind transmission fuel rate would be established in order to more accurately signal the variable cost of using the transmission system to market participants. SoCalGas intends to propose such a change in Phase II of this proceeding or in another relevant proceeding such as its BCAP.

7.2.5. Interconnection Policy

Another consideration in promoting access to new gas supplies is the interconnection policy applicable to upstream suppliers, including interstate pipelines and LNG regasification terminals.

SoCalGas and SDG&E propose to interconnect with any new supply source under the following conditions:

1. That the interconnection and physical flows do not jeopardize the integrity of, or interfere with, normal operation of the utility pipeline and storage system.
2. The interconnecting pipeline pays for all equipment necessary to effectuate deliveries at the interconnection, including, but not limited to, valves, separators, meters, quality measurement, odorant and other equipment necessary to regulate and deliver gas at the

interconnection point. The interconnecting pipeline must execute a standard Construction/Interconnection Agreement.

3. The interconnecting pipeline must execute a standard Operator Balancing Agreement with the utility. This agreement specifies a number of operating provisions, including minimum and maximum operating pressures, and balancing of actual deliveries and the scheduling of deliveries.
4. Customers and shippers of either pipeline system may use the point of interconnection as a scheduling point if the interconnecting pipeline abides by NAESB nomination/confirmation standards.
5. It will be the interconnecting pipeline's responsibility to deliver supply at the point of interconnection at a sufficient pressure to enter the utility system but at not less than the minimum operating pressure or more than the maximum operating pressure.
6. All supply must meet the requirements of utility's then current Tariff Rule 30 relating to gas quality specifications, or other rules, regulations, and/or requirements of any federal, state, or local or other agency having subject matter jurisdiction, including, but not limited to, the CPUC and the California Air Resources Board.
7. The physical capacity of the interconnection will be determined by the sizing of the point of receipt and the utility's ability to redeliver supply downstream of that point of receipt.
8. The receipt capacity for any particular day may be affected by physical flows from other points of receipt, physical pipeline and storage conditions for that day, and end-use demand.

The utilities state that the approval of this interconnection policy will provide potential new suppliers with a clear understanding of their obligations as they plan their upstream facilities.

7.3. Discussion – LNG Access Issues

Many parties favor the idea of California having the opportunity to access LNG. A number of the parties suggest that it is reasonable to require the utilities to provide open access to LNG facilities. Several parties also favor extending the access policies to new sources of supply other than LNG.

The thrust of a number of the comments, regarding the SoCalGas and SDG&E proposals, addressed the access options and related capacities and costs. Many of the commenting parties believe that a substantial amount of LNG can be accessed for very little money. According to the analyses of SoCalGas and SDG&E, on a displacement basis, up to 400 MMcfd can be accessed through Otay Mesa for approximately $7 million in infrastructure improvements. ORA notes that if the flow on the North Baja pipeline is reversed from west to east, as much as 500 MDth/d could be delivered from Baja Mexico to SoCalGas' Ehrenberg/Blythe delivery point on a firm basis. SoCalGas and SDG&E also estimate that 800 MMcfd of LNG could be accessed through Salt Works Station on a displacement basis, for approximately $5 million in infrastructure improvements; and 800 MMcfd through Center Road Station for approximately $1 million in infrastructure improvements. RACE believes these estimates need to be tested in the course of evidentiary hearings.

PG&E also discussed accessing LNG from Baja California in its Phase I proposal. Assuming regasified LNG flows east to Ehrenberg, as discussed above, it could be accessed if El Paso converts Line 1903 to natural gas service between Ehrenberg, and if PG&E (or El Paso) builds an interconnection between

that line and PG&E's Line 300. PG&E did not provide a cost estimate, but in comments NCGC stated it might cost about $100 million.

Other parties, including RACE, NRDC, and to some degree TURN, support the concept of first evaluating through evidentiary hearings California's need for LNG and its ramifications for the state's natural gas market. In a March 9, 2004 motion to modify the procedural schedule, RACE urges the Commission to consider the broader issues relating to California's natural gas needs and supply options before setting policies affecting LNG access and procurement. Among other topics, RACE believes that an evaluation of increasing California's dependence on foreign LNG supplies, the potential reduction in California demand for natural gas-fired electric generation due to increases in energy efficiency and renewable resources, the economic and environmental impacts associated with LNG, the relative inflexibility of LNG supply deliveries, and the effects of community choice aggregation on the utilities' core procurement portfolios, all should be considered before establishing policies designed to facilitate LNG. RACE further states that evidentiary hearings are necessary in order to allow parties to conduct discovery and adequately analyze, critique and respond to the utilities' filed proposals.

The utilities' requests to establish new receipt points to facilitate LNG access, goes beyond the concept of open access based on the current record, and we will not direct the establishment of receipt points at Otay Mesa, Salt Works Station, or Center Road Station at this time. Creating additional receipt points on the utilities' systems is a major policy decision that could create significant operational and ratemaking changes. Indeed, on the SoCalGas system, the change has the potential to be so profound as to reverse the historical north-to-south flow of natural gas around which the system was built. We are not

opposed to making such changes; indeed, they may be necessary in order to ensure California evolves with the changing energy marketplace. Rather, we agree with RACE that it would put the cart before the horse to establish additional receipt points to facilitate LNG gas supplies now, without first considering California's future need for natural gas, the other supply options, and alternatives for bringing LNG to the California market (as PG&E has suggested).

In Phase II of this proceeding, we will conduct hearings into these issues, as well as the actual price impacts of LNG in other areas of the United States, projected price impacts of LNG on California natural gas supplies, the deliverability of LNG vis a vis domestically-produced supplies, the impacts of LNG on California's as well as the production, liquification, and regasification area environments, the operational impacts on California's gas utility systems, and any gas quality differences between LNG and our utilities' existing supply sources. We intend to rule on the establishment of additional receipt points after gathering and considering this information.

In general, we favor open access policies and affirm that preference here. Open access helps to ensure reliable supplies and to discourage market manipulation; it also assures developers of new infrastructure that, at a minimum, if they build facilities to the utility's system, the utility will interconnect with those facilities.

The utilities' responses and the comments by parties on the various access options and related costs are relevant to our discussion below regarding the ratemaking treatment for infrastructure improvements.

7.4. Discussion – Ratemaking for Infrastructure Improvements

SoCalGas and SDG&E propose to roll-in (have ratepayers pay for) up to $200 million in LNG-related infrastructure improvements, as long as the utilities can show that there is a cost benefit in doing so. Both Coral and Sempra LNG, who support the roll-in proposal, intend to deliver regasified LNG to California from Mexico. SoCalGas and SDG&E indicate that to access large amounts of LNG from Mexico through Otay Mesa, related infrastructure improvements could be substantial (*e.g.*, $164 million for 700 MMcfd).

A number of parties oppose the roll-in proposal. Billiton and SES, who propose to provide LNG directly in California, state that they are willing to pay for the costs to access the system, which for like amounts of gas are less than Otay Mesa costs. Billiton indicates that the utilities' proposal effectively results in customers subsidizing the higher cost of entry for Baja LNG and that it is poor public policy to adopt subsidies that saddle ratepayers with potentially hundreds of millions of dollars of cost that can be avoided entirely. SES states that competition based on total delivered prices will result in the construction and operation of LNG facilities in a manner that is most cost effective for the California market.

Crystal, another potential California LNG supplier, states that it is not necessary, as SoCalGas suggests, that presumptions about cost thresholds (such as a rolled-in rate recovery structure) be in place in order to develop new receipt/interconnection points. Crystal states that customers should not be at risk for costs at the outset. Instead, the LNG supplier should be willing and positioned to assume up front cost responsibility. Crystal says that subsequent determinations on rate recovery structures may result in project refunds, if

rolled-in pricing ultimately proves to be appropriate, or credit backs if incremental pricing is maintained.

Other parties commented that the utilities' proposal would inappropriately benefit an affiliated company, *i.e.*, Sempra LNG. Regarding access to Baja LNG, ORA also argues that roll-in may not even be necessary, because large amounts of gas, up to 900 MMcfd, can flow from Mexico to California through the combined receipt points of Ehrenberg and Otay Mesa for very little money.

The roll-in proposal of SoCalGas and SDG&E would have the Commission authorize a process by which rates would be increased. However, rate matters are governed by the requirements of Pub. Util. Code Section 454, which requires an application, notice to customers of the proposed rate change, and a finding by the Commission that the new rate is justified. SoCalGas and SDG&E concede that the roll-in proposal will affect customers' rates.

Also, the issue of rolled-in versus incremental ratemaking treatment for particular utility facilities is complicated by the enormous uncertainty regarding LNG projects. Specifically, which facilities will ultimately be developed and when. No LNG terminal or other new supply source has started construction, and projects of this nature face significant hurdles before they can be completed. In addition, potential construction costs to accept and redeliver significant volumes of gas at multiple new receipt points varies widely, depending on which new sources of supply actually materialize and the volumes to be delivered at each new receipt point.

Based on the above concerns, it is appropriate to await the record to be developed in Phase II of this proceeding as well as further developments regarding the permitting and construction of LNG terminals before deciding the

extent, if any, to which backbone facility costs should be rolled-in to system-wide transportation rates. Once there is more information about which LNG terminals will actually be constructed and when, the utilities will be able to determine what the true costs of LNG access are. While a number of potential LNG suppliers have indicated that they are willing to pay the access costs, with more detailed and specific cost data, they can make a final determination as to whether they are willing to underwrite the access costs, or if they wish to have the Commission consider rolled-in rate treatment. We will therefore adopt a policy that presumes LNG suppliers will pay the estimated system infrastructure costs associated with their projects. However, requests for rolled-in, or any alternative ratemaking treatment, can be filed through the application process, with appropriate notice to customers. Those proposals, including the costs and cost recovery mechanisms, can then be evaluated on a case-by-case basis.

This policy will also apply to PG&E. PG&E proposed an application process on a case-by-case basis, but included the presumption that, if the project were approved, costs would be fully recoverable and rolled-in. Our adopted policy does not have a presumption of roll-in, for the reasons discussed above.

7.5 Discussion – Transmission System Integration

SoCalGas and SDG&E have raised a number of supply access issues, which have rate implications, including that of transmission system integration. The transmission integration proposal would resolve the problem of having two transportation charges if regasified LNG is transported over the transmission systems of SDG&E and SoCalGas to reach gas customers in SoCalGas' service territory. For efficiency reasons, SoCalGas and SDG&E currently operate their transmission systems as a single system. There were no objections to the continuation of this arrangement. Concerns over, and opposition to, the

SoCalGas and SDG&E proposal to integrate their transmission systems were principally related to the unknown rate effects of the proposal. In reply, the utilities agreed that rate effects of system integration should be considered in a proceeding devoted to rate matters, such as the BCAP.

SoCalGas and SDG&E should file a separate application to address transmission system integration issues. Both utilities acknowledge in their proposal that the rates of their customers will be affected by the system integration proposal. A utility specific ratemaking proceeding will provide an opportunity for parties to prepare responsive testimony and conduct cross-examination, and ensure conformance with the requirements of Pub. Util. Code Section 454 (a) relating to rate changes. That application should be filed within three months of the issuance of this decision, and it is our intention to address the issue in an expeditious manner.

Some parties commented that the issues associated with system integration are intertwined with the utilities' firm access rights proposal. ORA recommends that the two proposals be addressed simultaneously, since the adoption of a system of tradable firm access rights will likely influence the flow of gas on the various transmission paths. We agree that these two issues should not be decided in isolation. Since, as discussed below, we are also deferring consideration of firm access rights to a separate ratemaking proceeding, the utilities' filing for approval of the transmission system integration proposal should also include its request for approval of firm access rights.

While agreeing that system integration should be examined in a separate ratemaking proceeding, SoCalGas and SDG&E request that the Commission adopt a general policy supporting its proposal, in this decision. There is much to be said for system integration. The utilities cite regulatory and

scheduling simplicity. Also, potential operating efficiency problems associated with double receipt points would be eliminated. However, we are concerned with adopting a general policy on system integration without knowing all of the details and ramifications of the proposal itself. For instance, ORA does not agree with system integration at this time, claiming that the utilities are using the potential LNG supply through Otay Mesa as the impetus to seek a Sempra-wide transmission rate. ORA notes that through a reversal of flow, the North Baja Pipeline can move Baja LNG supplies into the SoCalGas system at Blythe/Ehrenberg and customers in the SoCalGas service territory do not necessarily have to use Otay Mesa as a delivery point for LNG supply originating from Baja. Other concerns may develop as the utilities' proposal undergoes further scrutiny.

These concerns need to be fully explored before adopting procedures, rules or any general policies such as those proposed by the utilities. Therefore, at this time, we will not adopt any general policy or principle on system integration. It is however our intention that any solution to transmission access problems will be based on efficiency and fairness to both affected ratepayers and suppliers.

7.6. Discussion – SoCalGas' Peaking Rate

A number of parties commented on SoCalGas' peaking rate, specifically requesting that it be eliminated. The Indicated Producers state that the peaking rate discourages customers from pursuing non-SoCalGas supply sources and is inconsistent with the goal of increasing new electric generation supplies in southern California. Questar indicates that the peaking rate is the only significant obstacle to its provisioning of new incremental pipeline capacity to the Los Angeles load center. SCGC states that if the rate were eliminated,

SoCalGas would be subject to competitive discipline in pricing gas transportation service to customers, which would facilitate transportation competition. Calpine and Watson also assert that without a peaking rate, SoCalGas will have stronger incentives to cut costs and to compete to retain and attract loads to its system.

In response, SoCalGas states the peaking tariff allows it to recover the costs of standing by to provide peaking service, to avoid shifting costs from large noncore customers to core customers, and is not anticompetitive as some noncore customers claim. The company explains that under its all-volumetric rate structure, there is a strong incentive for large noncore customers to take base load service from an interstate pipeline company charging straight fixed variable (SFV) rates and only take peaking service from SoCalGas. This is because an all volumetric rate structure does not impose a demand charge on the customer so that, unlike under SFV rates, the customer contributes to the utility's fixed costs of service only when it actually uses gas, even though the facilities necessary to provide the customer's peak demand remain in service. SoCalGas asserts that, unless the Commission keeps the peaking rate or adopts SFV rates for SoCalGas, the regulatory gap between the rates of SoCalGas and the interstate pipelines creates an incentive for large noncore customers to engage in uneconomic partial bypass of the SoCalGas system.

The peaking rate has been reviewed on four separate occasions and the Commission has continued to find that the peaking rate properly discourages uneconomic partial bypass of the SoCalGas system and thereby protects captive core customers. There are significant policies and rate issues associated with the peaking rate and it would be inefficient to address the elimination of the peaking rate again in this OIR. The BCAP has been the forum for addressing such peaking rate concerns in the past and is a proper venue for any further

reconsideration of this issue. However, since the peaking rate issue is also related to the transmission system integration proposal, the peaking rate issue may also be raised in the system integration/firm access rights proceeding.

7.7. Discussion – Kramer Junction

Even though SoCalGas' new interconnect with the Kern River pipeline at Kramer Junction is sized to allow 500 MMcfd of flow, there is a bottleneck problem at this interconnect. The bottleneck occurs because SoCalGas gives primary preference to its deliveries on the Transwestern and El Paso pipelines as a result of the agreement reached in the CSA, which was adopted by the Commission in D.01-12-018. For the same reason, shippers on Questar are only assured of 25 MMcfd flowing from Questar onto SoCalGas at North Needles, rather than the 80 MMcfd that Questar is physically capable of delivering. Appendix B of the CSA provides that the existing upstream capacity commitments of SoCalGas' core customers on El Paso and Transwestern can be utilized fully without being reduced by shipper deliveries at other receipt points. As a result of the CSA, SoCalGas limits the receipt of lower priced Rocky Mountain gas from Kern River at Kramer Junction to only 200 MMcfd, instead of what the interconnect is capable of flowing. PG&E, Kern River and Questar complain that this reduces deliveries of lower priced gas into the SoCalGas system by up to 300 MMcfd.

PG&E originally recommended that the Commission adopt a scheduling procedure for Kramer Junction that follows the capacity allocation process used at Wheeler Ridge. The Wheeler Ridge allocation process allocates take away capacity based on final scheduled volumes from two days prior.

SoCalGas cautioned that the Commission should consider the impact of PG&E's proposal on SoCalGas' core customers before ordering SoCalGas to

abandon its current scheduling processes. SoCalGas recommended that such a change should only occur when the Commission establishes a system of firm, tradable access rights.

SoCalGas proposed in it's April 6, 2004 Reply Comments to the Draft Decision that if the Commission wants to increase the receipt of Kern River gas while protecting SoCalGas' core customers, the Commission could allow shippers on the SoCalGas system to nominate up to another 300 MMcfd at Kramer Junction whenever less than 1390 MMcdf of supplies are scheduled at North Needles and Topock. Such a process, if adopted, would allow the volumes nominated at Kramer Junction to flow into the SoCalGas system if confirmed by the upstream pipeline.

One of the stated purposes of this OIR is to ensure sufficient gas supplies and infrastructure in order to meet the needs of California's residential and business consumers. If we adopt PG&E's recommendation to use the Wheeler Ridge approach for allocating capacity at Kramer Junction, there is no assurance that the core gas needs of SoCalGas will be met by using this capacity allocation method. Although we are keenly aware of the need for lower priced gas supplies, we do not believe that the primary preference for gas flows over Transwestern and El Paso should be eliminated at this time.

We will adopt SoCalGas' updated proposal as explained in the August 16, 2004 reply comments of SDG&E and SoCalGas. Under the updated proposal, which replaced SoCalGas' April 6, 2004 proposal, SoCalGas proposes to allocate receipt point capacity based on the physical capacities and expected flows of SoCalGas' North Desert Transmission Zone (Kramer Junction-Kern River, Topock-El Paso, North Needles-Transwestern, North Needles-Questar, and Hector Road-Mojave). If Cycle 2 scheduled quantities exceed the North

Desert transmission capacity of 1590 MMcfd, volumes would be reduced at the Kramer Junction and Questar receipt points in Cycle 3 in order to allow SoCalGas' core supplies to flow from El Paso and Transwestern. In the event scheduled quantities do not exceed the North Desert transmission capacity, additional gas supplies from Kern River and Questar will be able to flow into the SoCalGas system. SoCalGas' updated proposal should result in more Rocky Mountain gas supplies flowing onto SoCalGas' system, while allowing SoCalGas' core supplies to flow. SoCalGas shall be directed to make this change to its scheduling practices through the filing of an advice letter within two weeks from today.

We also note that this problem at Kramer Junction and North Needles is likely to be eliminated if the Commission adopts a system of firm tradable rights, and as the capacity contracts with Transwestern and El Paso expire.

7.8. Discussion – Firm Access Rights

The response to the SoCalGas and SDG&E firm access rights proposals varied from full support, to a claim that the proposals are beyond the scope of this proceeding and should be stricken. Many parties expressed concerns about certain aspects of the proposals, such as set asides, the level of reservation charges, the need to first unbundle the transmission network, the need for a price cap on secondary market transactions, and the auction process. Other parties found the proposals to be too complex and potentially too controversial to be resolved without further analysis. There was a general sentiment that the issues need to be addressed more fully through evidentiary hearings in either Phase II of this proceeding, the BCAP or other separate proceeding.

In D.04-04-015, we stated our general support for firm access rights for SoCalGas and implemented the CSA's proposal. However, that order was

stayed pending a decision in Phase I of this OIR. As explained in their OIR responses, SoCalGas and SDG&E claim, and some other parties agree, that many of the elements of the CSA proposal are now outdated and should not be implemented.

Today's decision also makes a change to SoCalGas' transmission system which should be considered, namely, to increase the flow of gas from Kern River through the Kramer Junction interconnect.

The effect of these changed circumstances on the firm access rights that we adopted in the CSA, and how this relates to the SoCalGas and SDG&E proposals, need to be examined. We find that evidentiary hearings are needed to fully develop the record and to respond to concerns raised in the comments of the other parties. We will therefore not adopt any proposal for firm access rights in this decision. Instead, as stated in our transmission system integration discussion, SoCalGas and SDG&E can file an application regarding its system integration and firm access right proposals. We will therefore continue the stay of D.04-04-015 until further notice.

SoCalGas and SDG&E recommend that if evidentiary hearings are deemed necessary on the firm access proposals, the Commission should at least adopt the following policies in this Phase I decision:

- New gas supplies should have the opportunity for equal access into the utility system
- New gas supplies should be allowed to compete on an equal footing with existing supplies.

The proposed statements are unopposed. They reasonably reflect our intentions to facilitate the development of alternative supplies and will be adopted.

7.9. Discussion – Off-System Deliveries

PG&E's Phase I proposal states that one manner in which its customers could gain access to LNG supplies from southern California would be if SoCalGas were to allow nominations from a Los Angeles city gate delivery point to an off system connection with PG&E. Initially this might be accomplished through displacement, and later by physically transporting LNG supplies to PG&E's system. A number of other parties also supported off system sales procedures.

SoCalGas indicates that PG&E's request is consistent with its proposals for a system of firm access rights that would create a city gate market and to sell interruptible backhaul services from the city gate to any receipt point on its system, where that gas could, in turn, then be delivered off system. While SoCalGas did not address the issue of firm off-system deliveries, which is equivalent to PG&E's discussion of physical deliveries of gas by SoCalGas to PG&E, it agrees that such deliveries might be necessary and indicates that it is evaluating the cost of facilities necessary to provide firm off-system deliveries along with an appropriate transportation rate and terms for such deliveries. SoCalGas should make its full showing on off-system deliveries in its upcoming system integration/firm access rights filing. This showing should be limited to off-system deliveries for natural gas to be consumed within California (e.g., into PG&E's service territory). Several parties who commented on the draft decision recommended that SoCalGas be allowed to make off-system deliveries to points other than PG&E. Since the focus of this OIR is to ensure that the natural gas needs of California's residential and business customers are met, SoCalGas' off-system deliveries should be limited to PG&E.

7.10. Discussion – Interconnection Policy

SoCalGas and SDG&E have proposed interconnection policies and indicated that they are unopposed and should be adopted. We note however that PG&E's proposal includes a recommendation that it and ultimately ratepayers should fund interconnections with LNG facilities. This conflicts with PG&E's current interconnection policies, as well as with the SoCalGas and SDG&E proposal, which requires all interconnection facilities be paid for by the interconnecting pipeline. At this time, PG&E's proposal is moot, since there are no potential LNG suppliers that would interconnect to PG&E, on the horizon. We also note that one policy that we are adopting and which appears to be supported by most parties, is that new gas supplies should be able to compete on an equal footing with existing supplies. Subsidizing LNG interconnections would be contrary to that policy. Therefore, we will not adopt this aspect of PG&E's proposal. The SoCalGas and SDG&E proposed policy should apply to all three utilities.

Interconnection policies were also the subject of the supplemental comments, which are discussed below.

7.11. Discussion – LNG Supplemental Issues

The Scoping Memo requested additional comments on the following LNG access issues:

1. What are the operational balancing agreements that have been or should be offered by respondents to the sponsors of the proposed LNG projects?
2. Should the respondents be allowed to have different provisions concerning quality specifications in their proposed operational balancing agreements for LNG projects, than the provisions concerning quality specifications in their Commission-approved tariffs?

3. Are there any other access issues involving potential LNG supplies, which have not yet been addressed and which would otherwise be left to the discretion of the respondents? If so, please identify the issues and propose how the Commission should address the issues.

Fifteen supplemental comments and seven supplemental reply comments were filed.

The operational balancing agreement addresses operational issues between the interconnecting pipeline and the gas utility's pipeline transportation system. It covers such topics as "scheduling practices, minimum and maximum pressure requirements, balancing, and compliance with gas quality standards established by this Commission and by other authorities." (SDG&E and SoCalGas, Initial Comments, p. 3.)

Regarding the first question about the operational balancing agreements, most of the parties state that all LNG shippers should have open and equal access to the gas utility's pipeline on a nondiscriminatory basis. Some of the parties point out that to do otherwise will provide one source of gas supply with an advantage over another, and lead to an uneven playing field. Several of the commenting parties recommend that the utilities submit model operational balancing agreements to the Commission for review and approval in an open manner.

SDG&E and SoCalGas support having standardized terms and conditions for providing access to all new upstream pipelines, including the terms and conditions associated with the operational balancing agreement. They recommend that the Phase I decision state that all upstream suppliers will be treated equally with respect to access into the utility's system, including equal treatment on the terms and conditions of the operational balancing agreement.

They also request that the Commission approve as part of the Phase I decision, their proposed interconnection policy, which contains the interconnection requirements that should be met by all new upstream pipelines.

SDG&E and SoCalGas attached a proposed pro forma operational balancing agreement to its comments on the supplemental LNG questions. They propose that this pro forma agreement be used as the basis for Commission approval of a standardized operational balancing agreement. SDG&E and SoCalGas state that having a standardized agreement will assure market participants that no particular upstream pipeline will receive preferential access over another upstream pipeline. They recommend that the Commission initiate an expeditious review of the proposed pro forma operational balancing agreement.

PG&E states that the Commission should not adopt a generic or statewide operational balancing agreement because of the different interconnection points that exist on its system. PG&E advocates that the operational balancing agreement should be left to the LNG project operator and PG&E to finalize. Other parties voiced similar concerns.

Several parties state that LNG supplies may lead to a situation where LNG supplies need preferential capacity due to the delivery timing of LNG supplies. Lodi states that the operational balancing agreement should not allow the LNG suppliers to reserve capacity for every day that it needs it, and to pay for it only when it is used. Instead, the Commission should ensure that the LNG supplier is treated like any other gas supplier, and be "subject to either a priority use scheme that applies to everyone, or to a demand charge to reserve capacity that includes the cost of reserving capacity every day but also allows the subscriber to resell that capacity to others, or to use it flexibly, *e.g.*, to put part or

all of the LNG in storage and use it at times when the tanker is not offloading to bring gas back out of storage." (Lodi, Initial Comments, pp. 3-4.) RACE states that "LNG suppliers should incur the costs of bringing an inflexible supply of natural gas onto the system." (RACE, Comments, p. 2.)

Some of the parties point out that there are likely to be some operational issues, which the utility and LNG shipper might have to work out on an individual case-by-case basis.

We will include in the Phase II hearings of this proceeding consideration of standardized operational balancing agreements to connect all new upstream gas pipelines that interconnect with the pipelines of SDG&E and SoCalGas, and to address the concerns raised by the parties regarding the use of a standardized operational balancing agreement.[14] Having a standardized agreement could help ensure that all upstream gas pipelines are treated on the same terms and conditions, and ensure that the upstream affiliates of SDG&E and SoCalGas will not be given any preference in their interconnection arrangements.

The second issue which the scoping memo seeks comment on is whether LNG supplies, when regasified, should meet different gas quality specifications than the gas quality specifications that are in the respondents' Commission-approved tariffs. The gas quality issue is important because it can

[14] At this point in time, it does not appear that a standardized operational balancing agreement for PG&E is necessary since there are no LNG projects seeking to interconnect with PG&E in the near future. Should the need arise to consider a standard agreement for upstream pipelines interconnecting with PG&E, PG&E may file an application to do so, or the new interconnecting pipeline project may bring the issue to the Commission's attention.

affect the safety and performance of gas-fired household appliances, manufacturing equipment, turbines, and compressed natural gas (CNG) vehicles. In addition, gas quality specifications can be affected by applicable air quality standards.

Billiton is concerned that in its discussions with SoCalGas concerning an operational balancing agreement, that SoCalGas has insisted that Rule 30 apply, and that the LNG supply also meet "other rules, regulations and/or requirements of any federal, state, or local or other agency having subject matter jurisdiction, including but not limited to the CPUC and California Air Resources Board." (Billiton, Comments, p. 4.) Billiton has no objection to meeting Rule 30, but is concerned that it may have "to comply with any and all unspecified rules or regulations that may be imposed at any time in the future by any unspecified agency." Billiton is concerned that such language could require it to meet future vague and unspecified future gas quality specifications, instead of the utility's gas quality specification tariff.

Sempra LNG mentions that if a waiver of any of the gas quality specifications or other interconnection requirements are needed, that the utility should "ensure that such a waiver would not cause any material adverse impact to the utility system or its operation," and if "no adverse impact would result, the requested waiver should be submitted for the Commission's approval by way of advice letter." (Sempra LNG, Initial Comments, pp. 1-2.) Coral also advocates that if an upstream supplier seeks to deviate from a specification, that the waiver should be granted "by the Commission if it is determined that a deviation from the utility's existing tariff will not compromise the integrity of the utility's transmission and distribution system or interfere with the gas-burning

equipment of customers served by the utilities." (Coral, Opening Comments, p. 4.)

Lodi states that gas suppliers who have the capability to blend "out of spec" gas into "spec gas" should be allowed to do so, and that this should be facilitated by the regulated infrastructure to the extent it is feasible to do so.

RACE is concerned that if an LNG supply is allowed to meet different gas quality standards, that this will result in either of the two following negative outcomes:

> "1) 'hotter' LNG gas is blended into pipeline trunklines, resulting in an incremental increase in bulk Btu content that is still within the quality specifications in the utilities' Commission-approved tariffs but that results in incremental increases in NOx emissions from uncontrolled combustion sources using the gas (stoves, hot water heaters, etc.), or 2) the 'hot' LNG is proposed to remove propane and ethane at the regasification terminal, as proposed by Mitsubishi in Long Beach, potentially exposing the local population to greater risk in event of a major accident than would otherwise be present."

SDG&E and SoCalGas comment that the existing gas quality specifications should not be changed unless it can be shown that the modifications will "not adversely affect health, safety, utility system integrity, or utility operating procedures." (SDG&E and SoCalGas, Initial Comments, p. 2.)

The comments note the various work that SoCalGas and others are involved in regarding LNG gas quality. The use of regasified LNG to fuel electric generation plants, and as CNG to fuel gas-fired vehicles, will involve the California Air Resources Board and the regional air quality districts. The CEC, the FERC, the utilities, and industry groups have also been studying this issue.

There are a number of ongoing activities studying the issue of LNG gas interchangeability. The Commission should coordinate statewide efforts with the CEC and other state agencies and conduct a workshop to thoroughly examine gas quality issues in the near future. The workshop process will provide participants and the Commission with a forum to examine the gas quality specifications and the related concerns in detail. The Energy Division is directed to submit into the records of this proceeding a workshop report for comments by all interested parties

All of the parties who addressed the gas quality issue agree that LNG shippers should have to meet the same gas quality specifications contained in the utility's tariff provisions. Until we decide whether the current gas quality specifications should be changed, all gas supplies entering the respondents' gas systems must continue to meet the current applicable gas quality specification tariff. It is our belief that the applicable utility's gas specification tariff should be the governing document regarding all of the gas quality specifications that the gas supplier must meet. Therefore, any changes to the gas quality specifications should be subject to the Commission's approval and reflected in the utilities' tariffs.

The comments regarding other access issues involving potential LNG supplies mentioned two issues. The first is that the introduction of LNG supplies will have system-wide implications, and that the gas flow on the various pipelines are likely to change significantly. This is likely to occur even if no West Coast LNG terminals are built, but LNG terminals are built in the Gulf of Mexico or on the East Coast. If LNG terminals are built to serve the gas needs of the eastern states, this is likely to result in more domestic gas supplies being made available to California.

Some of the Phase I proposals have noted that certain pipelines may have to be enlarged or additional equipment may be needed if LNG supplies on the West Coast are connected to the respondents' gas transportation system. The parties have also mentioned that gas flow patterns could change depending on which pipelines LNG gas suppliers have access to. Today's decision reflects those considerations. The Phase II hearings will address these issues in detail. Similarly, by not adopting the proposal to roll-in costs, all possible transportation options will be left open. Should a respondent seek to file a roll-in application, or an application to expand its system to accommodate the LNG supply, we will look at the impact of such proposals. In addition, by supporting a diverse supply of gas, we leave the door open for accessing reliable supplies of gas at competitive prices.

Lodi states that all of the components of the state's gas-delivery infrastructure should be made available on flexible terms. Lodi contends that this will allow customers to optimize the available services to meet their particular needs. Most, if not all, of these issues will be addressed in the firm access rights proposal, or elsewhere in Phase II.

8. Comments on Draft Decision

The alternate draft decision of Commissioner Lynch was mailed for comments on August 19, 2004. Comments were filed on _____, and reply comments were filed on _____.

9. Assignment of Proceedings

Michael R. Peevey and Susan P. Kennedy are the Assigned Commissioners, and John S. Wong and David K. Fukutome are the assigned Administrative Law Judges in this proceeding.

Findings of Fact

1. A diverse portfolio approach for the holding of interstate capacity across supply basins and interstate pipelines with staggered terms maximizes opportunities to benefit core customers with enhanced supply reliability and gas price stability.

2. By Commission order, SoCalGas, PG&E, SDG&E, Southwest and Edison cannot turn back capacity rights on interstate pipelines or release their capacity rights under long-term capacity release transactions unless and until the Commission authorizes such turn back of capacity or long-term releases.

3. The SoCalGas and SDG&E request to negotiate reduced amounts of capacity and to terminate expiring contracts with El Paso and Transwestern is consistent with the goal of achieving a more diversified portfolio.

4. A clearly articulated interstate pipeline capacity approval process, which is flexible and provides for expeditious processing and appropriate regulatory oversight, is needed to provide the utilities with the opportunity to acquire needed core capacity in the most efficient and cost effective manner.

5. It is appropriate to establish interstate pipeline capacity contract procedures now, rather than to delay.

6. The Commission's responsibility to ensure that the proposed contract approval procedures are consistent with the interests of ratepayers is complicated by the utilities' holding company structures and the associated affiliate company relationships.

7. In allowing the utilities flexibility in contracting for storage and pipeline capacity, and in providing the utilities with expedited pre-approval procedures for obtaining such capacities, it is reasonable to impose conditions to discourage utility decisions that would benefit its affiliates at the expense of ratepayers.

8. Both the contract length limit of 3 years and the capacity amount limits (100 MMcfd for PG&E and SoCalGas and 20 MMcfd for SDG&E) should apply in determining whether or not an interstate pipeline capacity contract can be processed under the pre-approved capacity range or authorized capacity commitment procedures.

9. The aggregate capacity of the contracts pre-approved under the pre-approved capacity range or authorized capacity commitment procedures, excluding ROFR, should be limited to 25% of a utility's core interstate pipeline capacity portfolio.

10. Utilities should not use the pre-approval process for any contracts with their respective affiliates.

11. The requests of SoCalGas, SDG&E and PG&E to establish and implement expedited advice letter procedures for pre-approval of certain interstate pipeline and storage capacity contracts is reasonable.

12. To allow pre-approval of potentially large or long-term interstate pipeline capacity contracts, with no formal Commission review or approval, is inconsistent with the Commission's duties and responsibilities.

13. For interstate pipeline contracts that cannot be accommodated under the timing of the expedited capacity advice letter procedures, it is reasonable to allow SoCalGas, SDG&E and PG&E to establish pre-approval through the pre-approved capacity range or authorized capacity commitment procedures, with the addition of a formal process that includes ED approval.

14. The SoCalGas, SDG&E and PG&E proposed interstate pipeline and storage capacity contract consultation processes with ORA, TURN, other interested non-supplier parties, and ED are reasonable.

15. It is reasonable to include both ORA and TURN and other interested non-supplier parties in the agreement aspect of the expedited pre-approval processes.

16. If agreement among parties is not reached in the expedited pre-approval processes, it is reasonable to allow the utility to seek approval through either the advice letter or application processes.

17. The capacity planning ranges proposed by SoCalGas and SDG&E could result in less than 100% of the annual average demand being contracted for over the year.

18. The cost of interstate capacity is relatively small as compared to the cost of gas in the spot market.

19. A conservative approach for setting the capacity planning ranges for SoCalGas and SDG&E is preferable to ensure that there is enough infrastructure to meet California's future demand for natural gas.

20. For SoCalGas and SDG&E, the proposed capacity planning range upper bound of 120% of the average daily amount encompasses peak conditions.

21. For SoCalGas and SDG&E, a capacity planning range with a lower bound set at the annual average daily amount and the upper bound set at 120% of the annual average daily amount, for both the winter and non-winter months, is reasonable.

22. PG&E has not justified its proposed capacity planning range.

23. It is reasonable to set the lower bound of PG&E's capacity planning range at the current level of 962 MMcfd. and to set the upper bound at 10% over that amount.

24. PG&E has not justified its proposed system reliability planning standards.

25. PG&E's system reliability standards should be addressed in the BCAP, or in a separate application.

26. SoCalGas and SDG&E should specifically include storage in their capacity contract approval processes, and such changes may be proposed in the standard advice letter procedure.

27. It is reasonable to include storage in the capacity contract approval processes.

28. A number of implementation issues need to be addressed before third parties can assist the utilities in providing incremental core storage.

29. The viability and costs related to interstate pipeline and storage capacity are more certain than those associated with the new LNG projects that are being proposed to serve California markets.

30. Because of uncertainties related to LNG projects, it is appropriate to review LNG matters more carefully than those related to interstate pipeline and storage capacity projects.

31. The issue of whether individual LNG projects should be built in California, or in Mexico, is or will be addressed in the applicable regulatory proceedings examining each individual project.

32. An open access policy will help prevent market manipulation and assure developers that, at minimum, if they build facilities to the utility's system, the utility will interconnect with those facilities.

33. SoCalGas' request to establish new receipt points goes beyond the concept of ensuring open access.

34. It is prudent to consider California's need for natural gas, other supply options, and the impacts of LNG on California's energy market before establishing additional receipt points that dramatically alter the flow on the SoCalGas system.

35. A number of parties, including potential LNG suppliers, oppose the SoCalGas and SDG&E proposal for rolled-in ratemaking for LNG related infrastructure improvements.

36. The SoCalGas and SDG&E proposal for rolled-in rates will affect customers' rates.

37. There is currently enormous uncertainty regarding which LNG projects will ultimately be developed and when.

38. It is appropriate to await further developments regarding the permitting and construction of LNG terminals before deciding the extent, if any, to which backbone facility costs should be rolled-in to system-wide transportation rates.

39. A policy that presumes LNG suppliers will pay the estimated system infrastructure costs associated with their projects should be adopted. However, requests for rolled-in, or any alternative ratemaking treatment, should be allowed through the application process and addressed on a case-by-case basis.

40. The SoCalGas and SDG&E proposal for transmission system integration is intertwined with its proposal to establish firm access rights.

41. Testimony and evidentiary hearings are necessary to give parties the opportunity to reasonably address rate impacts and other concerns on the SoCalGas and SDG&E proposals for transmission system integration and firm access rights.

42. The filing of a separate application by SoCalGas and SDG&E for its proposals for transmission system integration and firm access rights will ensure conformance with requirements of Pub. Util. Code Section 454 (a) relating to rate changes.

43. There is no assurance that the core gas needs of SoCalGas will be met if PG&E's recommendation to use the Wheeler Ridge approach for allocating capacity at Kramer Junction is adopted.

44. SoCalGas' updated proposal to allocate receipt point capacity based on the physical capacities and expected flows of SoCalGas' North Desert Transmission Zone should result in more Rocky Mountain gas supplies flowing onto SoCalGas' system, while allowing SoCalGas' core supplies to flow.

45. Firm off-system deliveries relate to SoCalGas' firm access rights proposal.

46. SoCalGas' peaking rate has been reviewed by this Commission on four separate occasions, in which the Commission has found that it properly discourages uneconomic partial bypass of the SoCalGas system.

47. The BCAP or the application regarding system integration and firm access rights are appropriate forums for addressing reconsideration of SoCalGas' peaking rate.

48. The firm access rights proposal of SoCalGas and SDG&E is not adopted in this decision.

49. PG&E's proposal that ratepayers should fund interconnection with LNG facilities is inconsistent with its current policy where interconnection costs are paid for by the interconnecting pipelines, and is inconsistent with our policy that LNG and existing supplies should compete on an equal footing.

50. The gas quality issue is important because it can affect the safety and performance of appliances, equipment, and vehicles which use natural gas, and may be affected by applicable air quality standards.

51. There are several ongoing activities that are looking into the gas quality issue for LNG supplies.

52. Until we decide whether the current gas quality specifications should be changed, all gas supplies entering the Respondents' gas systems must continue to meet the current applicable gas quality specification tariff.

53. The applicable utility's gas specification tariff should be the governing document regarding all of the gas quality specifications that the supplier must meet.

Conclusions of Law

1. The SoCalGas and SDG&E request to negotiate reduced amounts of capacity and to terminate expiring contracts with El Paso and Transwestern should be granted on existing expiring Transwestern or El Paso contracts, but SDG&E and SoCalGas should not be required to include ROFR provisions in renegotiated or new contracts. The granted authority should also apply to PG&E, Southwest and Edison with regards to their expiring contracts with interstate pipelines. The utilities should preserve their rights of first refusal with the interstate pipelines.

2. Pre-approved capacity contracts authorized under procedures granted in this decision should be subject to review and potential disallowance, insofar as the related utility actions benefited affiliated companies at the expense, or to the detriment, of utility ratepayers.

3. Procedures for processing interstate pipeline and storage capacity contract pre-approvals in an expeditious manner, with appropriate regulatory oversight, should be established and implemented for SoCalGas, SDG&E and PG&E.

4. Pre-approval for interstate pipeline capacity contracts under the pre-approved capacity range or authorized capacity commitment should be limited to only those transactions that cannot be accommodated under the time limits of the proposed expedited capacity advice letter process.

5. The Director of the ED should be delegated the authority to approve or disapprove those contracts that fall under the pre-approved contract criteria.

6. The adopted capacity ranges should be revisited in the utilities' respective BCAPs for possible adjustments.

7. SDG&E shall have until November 1, 2005 to operate within the adopted capacity range.

8. Southwest should work with ORA to develop a capacity contract approval procedure that meets the needs of Southwest consistent with the principles we are adopting for the other respondents.

9. The existing gas procurement mechanisms may require adjustments to accommodate changing structures of utility core portfolios.

10. PG&E, SoCalGas and SDG&E should submit, for Commission approval, non-discriminatory open access tariffs for all new sources of supply.

11. New receipt points at Otay Mesa, Salt Point and Center Road on the SoCalGas system should not be established at this time.

12. The Commission should hold evidentiary hearings in Phase II of this proceeding into California's future need for natural gas, other supply options, alternatives for bringing LNG to the California market, price impacts of LNG, projected price impacts of LNG on California, deliverability of LNG, and the environmental, gas quality and operational impacts of LNG as discussed in the body of this order.

13. Rate matters are governed by the requirements of Pub. Util. Code Section 454, which requires an application, notice to customers of the proposed rate change, and a finding by the Commission that the new rate is justified.

14. The SoCalGas and SDG&E proposals to establish an integrated transmission system and firm access rights should be considered jointly, in a separate application to be filed within three months of this decision.

15. SoCalGas' updated proposal to allocate receipt point capacity based on the physical capacities and expected flows of SoCalGas' North Desert Transmission Zone should be adopted, and SoCalGas should be directed to make this change.

16. A proposal for firm off-system deliveries into PG&E's service territory should be included in the SoCalGas and SDG&E application to establish an integrated transmission system and firm access rights.

17. New gas supplies should have the opportunity for firm access into the utility system and should be allowed to compete on an equal footing with existing supplies.

18. The SoCalGas and SDG&E proposal that interconnection facilities should be paid for by the interconnecting suppliers in all circumstances should be adopted and should be applied to PG&E as well.

19. A process should be initiated in Phase II to consider the adoption of standardized operational balancing agreements and to address the concerns of the parties regarding such agreements.

20. The Commission should coordinate with the CEC and other state agencies to examine gas quality issues in a technical workshop.

21. Today's order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Southern California Gas Company (SoCalGas), San Diego Gas & Electric Company (SDG&E), Pacific Gas & Electric Company (PG&E), Southwest Gas

Company (Southwest) and Southern California Edison Company are granted authority to negotiate reduced amounts of capacity and to terminate expiring contracts with El Paso Natural Gas Company, Transwestern Pipeline Company or Gas Transmission Northwest Corporation while preserving the rights of first refusal.

2. The requests by SoCalGas, SDG&E and PG&E to establish capacity contract approval procedures are granted, for an initial period of five years, subject to the modifications described in the body of this decision. Six months before the end of the initial period, the utilities are allowed to file an Advice Letter requesting the continuation or modification of these procedures.

3. Pre-approved capacity contracts authorized under procedures granted in this decision shall be subject to review and potential disallowance, insofar as the related utility actions benefited affiliated companies at the expense, or to the detriment, of utility ratepayers.

4. The Director of the Commission's Energy Division is delegated the authority to approve or disapprove capacity contracts that fall within the pre-approved contract criteria, and shall respond in a timely manner to a utility's written request seeking approval of such a contract.

5. Southwest shall work with the Office of Ratepayer Advocates to develop a capacity pre-approval process consistent with the principles adopted for the other gas utilities, and shall submit the proposed process for Commission approval through an advice letter filing.

6. Within 30 days of this decision, PG&E, SoCalGas and SDG&E shall submit, for Commission approval, non-discriminatory open access tariffs for all new sources of supply.

7. Within three months of the issuance of this decision, SoCalGas and SDG&E shall file an application to request implementation of its transmission system integration and firm access rights proposals.

8. SoCalGas shall within two weeks from today make the necessary system modifications to allow shippers on the SoCalGas system to nominate up to another 300 MMcfd at Kramer Junction whenever less than 1390 MMcfd of gas is scheduled at North Needles and Topock, and to make an advice letter filing to reflect this change.

9. Phase II of this proceeding shall examine broad supply and demand issues related to LNG as discussed in the body of this order, and establish a process to consider the adoption of standardized operational balancing agreements to connect all new upstream gas pipelines that interconnect with the pipeline systems of SDG&E and SoCalGas.

10. This proceeding remains open to consider Phase II issues.

This order is effective today.

Dated _____, at San Francisco, California.

CERTIFICATE OF SERVICE

I certify that I have by mail, and by electronic mail to the parties of which an electronic mail address has been provided; this day served a true copy of the original attached Alternate Draft Decision of Commissioner Lynch on all parties of record for proceeding R.04-01-025 or their attorneys of record.

Dated August 19, 2004, at San Francisco, California.

/s/ EVELYN P. GONZALES
Evelyn P. Gonzales

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

* *

The Commission's policy is to schedule hearings (meetings, workshops, etc.) in locations that are accessible to people with disabilities. To verify that a particular location is accessible, call: Calendar Clerk (415) 703-1203.

If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074, TTY 1-866-836-7825 or (415) 703-5282 at least three working days in advance of the event.