Decision 06-11-003 November 9, 2006

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs.	Application 00-11-038 (Filed November 16, 2000)
Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E)	Application 00-11-056 (Filed November 22, 2000)
Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527.	Application 00-10-028 (Filed October 17, 2000)

OPINION ALLOCATING THE BENEFITS AND COSTS OF A CALIFORNIA DEPARTMENT OF WATER RESOURCES NATURAL GAS CONTRACT

I. Summary

The California Department of Water Resources (DWR), in addition to its submission of its annual revenue requirement determination for 2006, requested that we allocate the benefits of a below-market gas contract between DWR and Williams Energy Marketing and Trading (Williams) that resulted from a negotiated settlement of issues arising from the energy crisis. Because the benefits of the contract flow from its currently below-market cost, we can allocate the benefits of the contract by allocating its costs, using the percentages adopted in Decision (D.) 05-06-060.

II. Procedural Background

DWR submitted its Determination of Revenue Requirements for 2006 on August 3, 2005, and submitted a Revised Determination on October 27, 2005. In a letter memorandum dated August 19, 2005, DWR requested that the Commission also specify how DWR should allocate the benefits from its gas supply contract with Williams, noting that "the cost of natural gas under this gas supply contract is currently below market." DWR requested that the Commission "explicitly specify whether the benefits from the Williams gas supply contract should be offset against either avoidable or non-avoidable costs allocated to SCE and SDG&E's service territories." (*Id.*, p. 2.)

In addition, Southern California Edison Company (SCE), The Utility Reform Network (TURN), and the California Large Energy Consumers Association (CLECA) filed a petition to modify D.05-06-060, the decision establishing the allocation methodology to be used in this proceeding. The petition to modify raised several issues, including the allocation of certain gas hedging costs and benefits. Briefs were filed by SCE, PG&E, and San Diego Gas & Electric Company (SDG&E), addressing the two issues of the allocation of the benefits of the Williams gas supply contract and the allocation of gas hedging costs and benefits.[1]

A draft decision was issued on November 2, 2005. Based on comments on the draft decision, this Commission deferred resolution of the allocation of the benefits of the Williams gas supply contract. (D.05-12-010, pp. 3, 12.) We have

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[1] DWR also submitted letter memoranda addressing these issues.

reviewed the pleadings and considered the arguments of the parties in more detail in the intervening period.

III. Allocation of the Williams Gas Contract

The Williams gas contract is a must-take contract, created as a result of the renegotiation of DWR's 2001 power contract with Williams. The most significant aspect of the Williams gas contract is that it provides gas that is currently well below market rates. The Commission allocated the gas from the Williams contract for operational purposes in D.03-10-016. In that decision, the Commission determined, based on DWR's recommendations, that for 2004, 84% of the gas would go to SCE and 16% would go to SDG&E, while for 2005-2010, 62% would go to SCE and 38% to SDG&E.

Subsequently, in D.05-03-024 and D.05-04-025, the Commission stated that it intended to address the allocation of the benefits of the below-market Williams gas contract in the process of the rehearing of D.04-12-014. Because the allocation methodology adopted in D.04-12-014 was superseded by the methodology adopted in D.05-06-060, the rehearing of D.04-12-014 became moot, and accordingly the issue was not addressed.

DWR raised the question of the allocation of the benefits of the contract in its August 19 letter memorandum. The parties in the proceeding disagree as to the proper allocation of the benefits of the contract. (Transcript, August 31, 2005 PHC, vol. PHC-17, pp. 629-633.)

The question we need to resolve is the nature of the benefits of the Williams gas contract. One possible answer is that the gas contract is essentially the same as the electricity contracts whose costs we have been allocating in this proceeding. The other possible answer is that the benefit of the Williams gas contract is unique, and more akin to a cash payment received as part of a negotiated settlement.

The former approach is taken by SCE and SDG&E, who argue that the Williams gas contract should be treated like the other DWR contracts that the Commission has allocated in the course of this proceeding. Under this approach, the costs are allocated based upon a determination of whether the costs of the contract are considered unavoidable or avoidable, and the gas itself is the benefit.

If the contract costs are unavoidable (SCE's position), the costs are pooled with all other contract costs and allocated according to the percentages adopted in D.05-06-060, and the "benefits," which consist of cheap gas, simply flow where they were allocated in D.03-10-016. On the other hand, if the contract costs are considered avoidable (SDG&E's position), then the costs follow the allocation of the contracts, meaning that SCE pays 84% of the costs for 2004 and 62% of the costs for 2005-2010, with SDG&E paying 16% of the costs for 2004 and 38% of the costs for 2005-2010. Again, the benefits would flow with the gas.

SDG&E, in its November 22, 2005 comments on the initial draft decision, argues that its position is more nuanced than this characterization. SDG&E argues that the allocation of the costs and benefits of the Williams gas contract should be based upon the allocation of the costs of the DWR power contracts that the Williams gas is used to fuel. (SDG&E 11/22/05 Comments, p. 3.) Under SDG&E's argument, since all of the DWR contracts allocated to SDG&E for operational control are avoidable, the Williams gas costs and benefits should be allocated to SDG&E in the same way as the avoidable power contracts. (*Id*.)

As SCE points out in its Reply Comments, SDG&E's argument simply does not matter: "However, the use of the Williams gas supply is not relevant to the allocation of contract costs. The Williams gas deliveries are must-take, and the costs are therefore unavoidable." (SCE 11/28/05 Reply Comments, p. 2.)

PG&E argues that the Williams gas contract is unique, and is different from DWR's electricity contracts. PG&E points out that the Williams gas contract was part of a negotiated settlement of claims relating to the energy crisis, and that the Commission allocated it for operational purposes in a different manner than used for electricity contracts. Based on this, PG&E argues that the benefits of the contract should not automatically be allocated in the same manner as the costs and benefits of DWR's electricity contracts. PG&E recommends that the benefits of the gas contract, specifically the difference between the market price and the contract price of the gas, be shared among the utilities using the fixed percentages adopted in D.05-06-060. (PG&E Opening Brief, pp. 2-6.)

PG&E's argument (while focusing only on benefits and ignoring costs) is more factually sound, as the Williams gas contract is in fact a unique entity, and is not directly comparable to DWR's electricity contracts. As a part of a negotiated settlement, it was entered into for the purpose of benefiting all California ratepayers, and as a new and separate item, its benefits are in fact more comparable to a cash settlement than to an existing (or renegotiated) electricity contract.[2]

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[2] This Commission has previously described some of the differences between the gas contract and DWR electricity contracts:

> Unlike the DWR long-term power supply contracts that were allocated in D.02-09-053, the Williams Gas Contract will be administered by DWR. Legal title, financial reporting responsibility and responsibility for contract-related bills will remain with DWR. DWR will perform most contract administration activities and financial settlements. The utilities will only be

Footnote continued on next page

In addition, PG&E's general position is more consistent with our previous determinations on this issue. In D.03-10-016, we stated:

> For equity purposes, it would be desirable to allocate some of the Williams volumes to PG&E, however, such an allocation would be inconsistent with the goal of matching the Williams gas volumes to the physical needs of the DWR long-term contracts to the extent possible. (*Id.*, p. 9.)

In D.03-10-016, we were concerned with allocation of the Williams gas contract for operational purposes. That constrained our ability to allocate some of the Williams volumes, and the corresponding benefits, to PG&E. Here, however, we are looking at allocation of the dollar costs and benefits of that contract, and we can now do what is equitable, and allocate some of the financial benefits of the contract to PG&E, albeit not as many as PG&E requests.

Accordingly, we respond to DWR's August 19, 2005 request by specifying that the benefits of the Williams contract should be offset against the non-avoidable costs of the DWR contracts. Consistent with its current practice, DWR will continue to produce a forecast of the difference between the market price and contract price in its annual revenue requirement, and continue to subtract that amount from its total estimated non-avoidable costs before those costs are allocated to PG&E, SCE and SDG&E. In this manner, each utility clearly receives

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responsible for scheduling the Williams gas volumes allocated to them. (D.03-10-016, p. 8.)

a share of the Williams benefit on a forecast basis, because its share of allocated DWR costs is lowered by its share of the estimated benefit.[3]

This forecast will be subsequently trued-up after the fact using the actual costs and volumes of Williams gas that are reported to DWR by SCE and SDG&E. DWR should record the actual Williams costs as "non-avoidable," and allocate those costs to PG&E, SCE and SDG&E according to the allocation percentages adopted in D.05-06-060. Thus, each utility will receive the same share of the Williams benefit on a recorded basis as it received on a forecast basis.

For cost allocation purposes, the must-take nature of the contract also makes it more comparable to a non-avoidable cost, as argued by SCE. (SCE Opening Brief, p. 8, SCE Reply Brief, p. 10.) All parties agree that dispatch decisions are made based on the avoided cost of the generating facility, rather than upon the actual cost of the gas. (See, e.g. SCE Reply Brief, pp. 8-9.) Accordingly, since the cost allocation does not affect dispatch decisions, a cost-follows-contracts approach is unnecessary.

In its November 22, 2005 comments on the draft decision, PG&E supports the general outcome of the draft decision, but claims that the draft decision contains a computational error. According to PG&E, the error results in the draft decision being inconsistent with our stated intention of adopting PG&E's proposed allocation method. (*Id.*, pp. 2-9.)

As SDG&E points out, however, PG&E's claim and proposed "correction" actually result in PG&E obtaining a 42.2% share of the benefits of the Williams

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[3] If the forecast of the market price is below the Williams contract price, then the estimated benefits will be negative, and the Williams contract will increase non-avoidable costs. Each utility will receive a share of this negative "benefit."

gas contract, but avoiding paying any share of the costs of the Williams gas contract. (SDG&E November 28, 2005 reply comments, pp. 2-4.) It appears that PG&E only applied its logic to the benefits of the Williams gas contract, not the costs. As stated by SDG&E (who disagrees with the policy of the draft decision), our approach is fully consistent with our stated intent to allocate both the benefits and the costs of the Williams gas contract. (*Id.*) We decline to provide a windfall to PG&E, and accordingly decline to make the correction requested by PG&E.

The allocation methodology we adopt today shall be applied to DWR's recorded costs for 2005 and 2006, and utilized as appropriate in Rulemaking (R.) 06-07-010.

IV. Assignment of Proceedings

Geoffrey F. Brown is the Assigned Commissioner and Peter V. Allen is the assigned Administrative Law Judge (ALJ) in these proceedings.

V. Rehearing and Judicial Review

This decision construes, applies, or implements the provisions of Chapter 4 of the Statutes of the 2001-02 First Extraordinary Session (AB 1X) and relates to the determination or implementation of the DWR revenue requirements, or the establishment or implementation of bond or power charges necessary to recover those revenue requirements. Therefore, Pub. Util. Code § 1731(c) (applications for rehearing are due within 10 days after the date of issuance of the order or decision) and Pub. Util. Code § 1768 (procedures applicable to judicial review) are applicable.

VI. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311 and Rule 14.2(a) of the Commission's

Rules of Practice and Procedure. Comments were filed by PG&E, SDG&E, and SCE. PG&E reiterated its argument for its preferred allocation approach, and vigorously argued that the draft decision erred in not adopting all of PG&E's position. SDG&E also largely just reiterated its own argument, but conceded that the draft decision would be a reasonable compromise if applied prospectively. SCE, while taking issue with the logic of the draft decision, found it to be a reasonable compromise approach, and did not object to its adoption by the Commission.

Reply Comments were filed by PG&E, SDG&E, and SCE. PG&E and SDG&E used their Reply Comments as a platform to again repeat their arguments in support of their own positions. SCE, however, used its Reply Comments to discredit PG&E's criticisms of the draft decision:

> PG&E contends that the DD [draft decision] is "fundamentally unfair" because the DD refuses to allocate the "benefits" of the Williams gas supply contract to PG&E's customers without a corresponding allocation of the costs of the contract. In support of this unfounded assertion, PG&E presents a confusing (and at times contradictory) series of arguments and calculations that it claims somehow demonstrate that the only equitable result for the Commission to adopt is to disregard the permanent allocation methodology adopted in D.05-06-060 to ensure that PG&E's customers receive a 42% share of the financial "benefits" of the Williams gas supply contract, and almost no share (if any at all) of the contract's costs." (SCE Reply Comments, p. 2.)

PG&E's claims of error are without merit. The draft decision strikes a reasonable compromise result, and while we have modified some language in the decision to clarify its logic and its description of DWR's practices, no substantive changes need to be made as a result of the Comments.

Findings of Fact

1. The Williams gas supply contract is unique, and differs from DWR's electricity supply contracts.

2. The Williams gas supply contract was allocated for operational purposes in D.03-10-016.

Conclusions of Law

1. The costs and benefits of the Williams gas supply contract need not be allocated the same way as the costs of electricity supply contracts.

2. Equity supports allocating some of the benefits and costs of the Williams gas supply contract to PG&E.

3. This decision construes, applies, or implements the provisions of Chapter 4 of the Statutes of the 2001-02 First Extraordinary Session (AB 1X) and relates to the determination or implementation of the DWR revenue requirements, or the establishment or implementation of bond or power charges necessary to recover those revenue requirements.

O R D E R

IT IS ORDERED that:

1. The benefits and costs of the Williams gas contract are allocated using the percentages adopted in Decision 05-06-060, as described above.

2. Pub. Util. Code § 1731(c) (applications for rehearing are due within 10 days after the date of issuance of the order or decision) and Pub. Util. Code § 1768 (procedures applicable to judicial review) are applicable to this decision.

3. Applications 00-11-038, 00-11-056, and 00-10-028 are closed.

This order is effective today.

Dated November 9, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners