Decision 08-01-010 January 10, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY (U39M) to issue, sell, and deliver one or more series of Debt Securities and to guarantee the obligations of others in respect of the issuance of Debt Securities, the total aggregate principal amount of such long-term indebtedness and guarantees not to exceed $2 billion; to execute and deliver one or more indentures; to sell, lease, assign, mortgage, or otherwise dispose of or encumber utility property; to issue, sell and deliver in one or more series, an aggregate amount not to exceed $200 million par or stated value of First Preferred Stock – $25 Par Value; to issue an aggregate $2.0 billion of short-term debt obligations; to utilize various debt enhancement features; enter into interest rate hedges; and for an exemption from the Commission's Competitive Bidding Rule.	Application 04-05-041 (Filed May 27, 2004)

OPINION GRANTING IN PART AND DENYING IN PART PACIFIC GAS AND ELECTRIC COMPANY'S PETITION TO MODIFY DECISION 06-11-006

1. Summary

Pacific Gas and Electric Company (PG&E) is required by Ordering Paragraph (OP) 5 of Decision (D.) 06-11-006 to provide notice every time its net margin calls on gas hedges reach $300 million, $600 million, $900 million, and each $300 million increment thereafter. In response to PG&E's petition to modify D.06-11-006, today's opinion limits the notice required for each $300 million reporting increment to once per calendar quarter. This opinion also requires

PG&E to exclude from its notices any statements to the effect that potential losses on gas hedges will be offset by the lower gas prices.

2. Background

PG&E is authorized by D.06-11-006 to issue $2 billion of short-term debt for several specified purposes. One such purpose is to finance margin calls on gas hedges. The function of the hedges is to protect PG&E's core gas and electric customers from significant increases in the price of natural gas.[1]

Gas hedges can have significant financial risks. For example, if PG&E hedges against an increase in the price of natural gas by agreeing to buy large quantities at a fixed price, and the market price of gas declines below the fixed price, ratepayers will be worse off with the hedge. Under this scenario, PG&E's counterparty may demand collateral from PG&E to mitigate the risk that PG&E will not pay the agreed-upon price, and instead purchase lower cost gas from another party. The demand for collateral constitutes a "margin call." Depending on the counterparty, a margin call could be in the form of cash or letters of credit.

In D.06-11-006, the Commission expressed concern about PG&E's admission that margin calls on gas hedges could reach $900 million. If this were to occur, it could signal the possibility of an impending large-scale failure of PG&E's hedging activities in that PG&E's ratepayers might have to pay $900 million more than the then-current market price of gas.

In light of this risk, the Commission concluded in D.06-11-006 that it should monitor PG&E's gas hedging activities. To this end, OP 5 of D.06-11-006 required PG&E to provide notice whenever margin calls that are not offset by

[1] PG&E purchases a substantial amount of electricity from gas-powered generators. The prices paid by PG&E for this power are tied, in large part, to the price of gas.

other hedges ("net margin calls") reach $300 million, $600 million, $900 million, and each $300 million increment thereafter.

3. PG&E's Petition to Modify OP 5 of D.06-11-006

PG&E filed a petition to modify D.06-11-006 on September 28, 2007.[2] The petition was filed within one year of D.06-11-006, consistent with Rule 11.4(d) of the Commission's Rules of Practice and Procedure (Rules). Notice of the petition appeared in the Daily Calendar on October 1, 2007. There were no protests or other responses to the petition.

On October 16, 2007, the assigned Administrative Law Judge (ALJ) directed PG&E to file a document containing additional information regarding its petition. PG&E filed the document on November 29, 2007.

PG&E's petition seeks to modify OP 5 to reduce the notice required for each reporting threshold to once per calendar year. For example, once PG&E has provided notice that its net margin calls have reached $300 million, no further notice would be required for that threshold for the rest of the calendar year.

PG&E asserts that OP 5 has proven to be more burdensome than anticipated. This is because PG&E has had to file the notice required by OP 5 multiple times during the past year as margin calls fluctuated around the $300 million threshold. According to PG&E, the Commission does not need repetitious filings in order to monitor significant margin calls.

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[2] The petition was served on the service lists for this proceeding, Application (A.) 04-05-041 and A.06-05-007, and Rulemaking (R.) 01-10-24, R.04-04-003, and R.04-10-025.

4. Discussion

The primary issue posed by PG&E's petition is whether the Commission should relax the reporting requirements set forth in OP 5 of D.06-11-006. The Commission has broad discretion to grant or deny the petition, and to take such other actions with respect to the petition as the Commission deems necessary to protect and promote the public interest.

PG&E's gas hedges could result in up to $900 million of additional costs to PG&E's customers. In light of this substantial financial risk, we affirm our conclusion in D.06-11-006 that it is necessary to closely monitor PG&E's gas hedging activities.[3] OP 5 achieved this objective by requiring PG&E to provide notice when net margin calls on gas hedges reached specified levels.

PG&E argues that it has been required by OP 5 to file far more notices than needed to achieve our monitoring objective. We agree. The docket card for this proceedings shows that during the first 11 months of 2007, PG&E filed ten notices pursuant to OP 5 with respect to the $300 million reporting threshold as net margin calls repeatedly rose and fell.[4] This frequency of reporting is not necessary. On the other hand, because of the significant financial risks involved, we are not persuaded that it would be prudent to reduce the reporting frequency for each $300 million increment to once per year as recommended by PG&E.

We conclude that we can achieve our monitoring objective and lessen the regulatory burden on PG&E by reducing the maximum frequency of the notice required by OP 5 to once per calendar quarter for each reporting threshold. For example, if the $300 million reporting threshold is repeatedly reached during a

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[3] D.06-11-006, *mimeo.*, p. 9.

[4] There were no notices for threshold levels of $600 million and higher.

calendar quarter because of fluctuating levels of margin calls, PG&E will only have to provide notice the first time the $300 million threshold is reached during the quarter, but not for each subsequent time during the quarter. PG&E's obligation to provide notice with respect to the $300 million threshold will start anew the following calendar quarter.

To implement the revised notice requirement, we will modify OP 5 to include the following text shown in bold and underlined font:

> PG&E shall file and service notice when margin calls that are not offset by other hedges reach $300 million, $600 million, $900 million, and each $300 million increment thereafter **<u>for the first time in each calendar quarter</u>**. The notice shall include (i) the potential per-customer impact of the margin calls, (ii) an estimate of the likelihood of higher margin calls, and (iii) a description of the steps that PG&E has taken or will take to mitigate the ratepayer impact of the margin calls. PG&E shall file and serve the notice within five business days of the margin calls reaching the previously specified levels. The notice shall be served on the service lists for (i) the consolidated proceedings in which D.06-08-027 was issued, (ii) Application No. 06-05-007, and (iii) PG&E Advice Letter 2685-E, which was approved in Resolution E-3951. **<u>Once margin calls not offset by other hedges have reached a given threshold identified above, and PG&E has filed and served the notice required in the first sentence of this ordering paragraph, no additional notification is required if PG&E subsequently passes the same threshold again within the same calendar quarter</u>**.

The reporting requirements of OP 5, as modified by today's opinion, do not affect PG&E's obligation under the Public Utilities Code[5] to provide information regarding its gas hedging activities. As required by §§ 314 and 581,

[5] All statutory references are to the Public Utilities Code unless otherwise indicated.

PG&E shall promptly provide information concerning its gas hedging activities whenever requested by the Commission or its staff.[6]

In its comments on the proposed decision, PG&E stated that the revised reporting requirements adopted by today's opinion are acceptable to PG&E.

5. Elimination of Certain Content from the Notices

On its own initiative, PG&E has included the following statement in many of the notices that it has filed pursuant to OP 5:

> The ultimate impact of the hedges underlying the margin calls will depend on the conditions when the hedges are settled. If the hedges in PG&E's electric portfolio settle at their current mark-to-market value, any loss on the hedges would be offset by a corresponding gain on a comparable amount of the physical commodity that they are hedging.

The assigned ALJ's proposed decision recommended that the above text be deleted from future notices filed by PG&E because, among other reasons, the text is unrelated to the reporting objectives of OP 5. PG&E agreed with the ALJ's recommendation in its comments on the proposed decision. Accordingly, we will direct PG&E to henceforth exclude from the notices that it files pursuant to OP 5, as modified by today's opinion, any statements to the effect that the potential losses on gas hedges will be offset by the lower cost of the physical commodity.

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[6] Section 314 states, in relevant part, as follows: "The commission, each commissioner, and each officer and person employed by the commission may, at any time, inspect the accounts, books, papers, and documents of any public utility." Section 581 states: "Every public utility shall furnish to the commission in such form and detail as the commission prescribes all tabulations, computations, and all other information required by it to carry into effect any of the provisions of this part, and shall make specific answers to all questions submitted by the commission."

6. Comments on the Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and Rule 14.3 of the Commission's Rules. PG&E filed comments on December 27, 2007. These comments have been reflected, as appropriate, in the final decision adopted by the Commission.

7. Assignment of the Proceeding

Michael R. Peevey is the assigned Commissioner and Timothy Kenney is the assigned ALJ in this proceeding.

Findings of Fact

1. PG&E is authorized to use hedges to protect its gas and electric ratepayers from significant increases in the price of natural gas.

2. PG&E's margin calls on gas hedges may pose a significant financial risk to PG&E's core gas and electric customers.

3. PG&E is required by OP 5 of D.06-11-006 to notify the Commission each time PG&E's net collateral postings on gas hedges (net margin calls) exceed $300 million, $600 million, $900 million, and each $300 million increment thereafter.

4. PG&E's petition to modify D.06-11-006 seeks to reduce the notice required by OP 5 to once per calendar year for each $300 million reporting increment.

5. There is no opposition to PG&E's petition.

6. During the first 11 months of 2007, PG&E filed the notice required by OP 5 on ten separate occasions as net margin calls fluctuated above and below the $300 million reporting threshold.

7. The Commission can adequately monitor PG&E's net margin calls if OP 5 is modified to limit the notice requirements therein to once per calendar quarter for each $300 million reporting increment.

8. PG&E has unilaterally included in the notices that it has filed pursuant to OP 5 a statement to the effect that potential losses on gas hedges will be offset by the lower cost of the physical commodity. PG&E has agreed to henceforth exclude this statement from its future notices filed pursuant to OP 5.

Conclusions of Law

1. The Commission has broad discretion to grant or deny PG&E's petition to modify D.06-11-006, and to take such other actions with respect to the petition as the Commission deems necessary to protect and promote the public interest.

2. In order to reduce the regulatory burden of OP 5 while maintaining the Commission's ability to monitor significant financial risks arising from PG&E's gas hedging activities, OP 5 should be modified to limit the notice requirements therein to once per calendar quarter for each $300 million reporting increment.

3. The notices that PG&E files pursuant to OP 5 of D.06-11-006, as modified by this opinion, should not include statements to the effect that potential losses on gas hedges will be offset by the lower cost of the physical commodity.

4. The following order should be effective immediately so that the regulatory burden associated with OP 5 is reduced as quickly as possible.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company's (PG&E) September 28, 2007, petition to modify Decision (D.) 06-11-006 is granted and denied to the extent set forth in the following ordering paragraphs.

2. Ordering Paragraph (OP) 5 of D.06-11-006 is modified to include the following additional text shown in bold and underlined font:

> PG&E shall file and service notice when margin calls that are not offset by other hedges reach $300 million, $600 million, $900 million, and each $300 million increment thereafter **<u>for the first time in each calendar quarter</u>**. The notice shall include (i) the potential per-customer impact of the margin calls, (ii) an estimate of the likelihood of higher margin calls, and (iii) a description of the steps that PG&E has taken or will take to mitigate the ratepayer impact of the margin calls. PG&E shall file and serve the notice within five business days of the margin calls reaching the previously specified levels. The notice shall be served on the service lists for (i) the consolidated proceedings in which D.06-08-027 was issued, (ii) Application No. 06-05-007, and (iii) PG&E Advice Letter 2685-E, which was approved in Resolution E-3951. **<u>Once margin calls not offset by other hedges have reached a given threshold identified above, and PG&E has filed and served the notice required in the first sentence of this ordering paragraph, no additional notification is required if PG&E subsequently passes the same threshold again within the same calendar quarter.</u>**

3. The notices that PG&E files pursuant to OP 5 of D.06-11-006, as modified by this order, shall not include any statements to the effect that potential losses on gas hedges will be offset by the lower cost of the physical commodity.

4. Application 04-05-041 is closed.

This order is effective today.

Dated January 10, 2008, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
TIMOTHY ALAN SIMON
Commissioners