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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION **RESOLUTION E-4276**
October 29, 2009

(PUBLIC)
R E S O L U T I O N

Resolution E-4276. Pacific Gas and Electric Company (PG&E) request for approval of its hedging plan revisions.

Proposed Outcome: PG&E proposes to revise its hedging plan for its electric portfolio, including changes to: (1) the types of procurement products which are pre-authorized; (2) the brokerages and exchanges with whom PG&E is authorized to deal; (3) guidelines for hedging; and (4) guidelines for responding to changes in the company's liquidity position.

PG&E's proposals are approved.

Estimated Cost: None

By Advice Letter 3482-E filed on June 26, 2009, and Advice Letter 3492-E filed on July 10, 2009.

SUMMARY

This Resolution approves the changes to PG&E's Conformed 2006 Long Term Procurement Plan (LTPP) and its confidential Hedging Plan proposed by PG&E in Advice Letters (ALs) 3482-E and 3492-E. The changes relate to: (1) the types of procurement products which are pre-authorized; (2) the brokerages and exchanges with whom PG&E is authorized to deal; (3) guidelines for hedging; and (4) guidelines for responding to changes in the company's liquidity position.

BACKGROUND

AL 3482-E proposes changes to PG&E's publicly-available Conformed 2006 LTPP while AL 3492-E proposes changes to its confidential Hedging Plan (Appendix B of the Conformed 2006 LTPP). Decision (D.) 07-12-052 ordered that all updates to the utilities' Conformed 2006 Long Term Procurement Plans (LTPPs) filed between the biennial procurement plan filings be filed via advice letter and include both red-line and "clean" versions of the proposed changes. PG&E ALs 3482-E and 3492-E contain red-line and clean versions of their proposed changes. PG&E met with Energy Division prior to filing the advice letters to explain the content as well as the motivations for the changes. PG&E also explained the proposed revisions to the PG&E Procurement Review Group (PRG).

In AL 3482-E PG&E proposes the addition of new authorized procurement products, a rearrangement of some of the associated tariff pages, and a revised list of pre-approved brokerages and exchanges. Most of the changes to the list of procurement products are based on PG&E's need to reduce liquidity risk, which has become an increased concern recently due to tighter lending practices.

<u>Proposed new products and/or modifications:</u>

PG&E wishes to add margin-free swaps to its tool kit. These are financial swaps (already included among authorized products) with a key difference – PG&E is not required to post collateral when commodity prices move in favor of the counterparty to the swap beyond amounts that would typically trigger margin calls. These margin-free swaps can be either symmetrical (both parties are exempt from posting) or asymmetrical (only PG&E is exempt from posting collateral, or margin). PG&E's counterparties will charge an added fee. In response to an Energy Division data request about the added exposure that margin-free swaps would expose ratepayers to, PG&E stated that it prefers contracts that require the counterparty to post margin, but wishes to have this instrument available for the eventuality that it might not find a counterparty willing to post.

PG&E also seeks to add Credit Intermediation Arrangements (CIA) to its list of authorized products. In a CIA, PG&E enters into a contract with an intermediate entity such as a bank, which assumes PG&E's hedging agreement obligations to its counterparties. Simultaneously, PG&E and the bank enter into a financial swap agreement, under which the bank would become PG&E's hedging counterparty. Under the CIA PG&E is no longer required to post margin in response to unfavorable mark-to-market values. In return for this avoidance of posting margin, PG&E pays the intermediary entity a fee.

PG&E is currently authorized to employ counterparty sleeves for physical gas transactions. This product facilitates a transaction with an uncontracted or non-creditworthy entity through a contracted, creditworthy entity. PG&E requests that this type of arrangement also be allowed for natural gas financial products. PG&E also seeks to clarify that counterparty sleeves for electric supply apply to both physical and financial products.

PG&E also seeks to clarify that counterparty credit insurance (risk mitigation for a fee), which PG&E is already authorized to use, applies to physical and financial products for both electricity and gas.

Financial swaps for natural gas and electricity: PG&E seeks to enhance the definition of swaps to include examples of locational spreads (a.k.a. basis spreads), time spreads (a.k.a. calendar spreads), and cross commodity spreads (a.k.a. heat rate spreads). PG&E seeks the same enhanced definition of financial options for natural gas and electricity.

<u>New counterparty entities for physical and financial gas trades:</u>

PG&E maintains a list of authorized brokerages and exchanges (Appendix H of its Conformed 2006 LTPP). PG&E seeks to add to the list Natural Gas Exchange; J.P. Morgan Futures, Inc.; Mizuho Securities, USA; and Wells Fargo Advisors, LLC, and remove R.J. O'Brien from its authorized listing, while updating the name for Barclays Capital Europe.

In response to an Energy Division data request, PG&E explained that in deciding whether or not to include a futures clearing merchant (FCM) from the list, it used four criteria: (1) the FCM is a member of both New York Mercantile Exchange (NYMEX) and the Intercontinental Exchange (ICE); (2) the FCM is associated with a highly rated bank or financial institution; (3) the FCM demonstrates a strong commitment to the clearing business; and (4) the FCM provides good customer service and has consistent operational performance.

PG&E's response to the data request explained how Morgan, Mizuho, and Wells meet all these criteria. PG&E explained how the Natural Gas Exchange was added because it provides a unique clearing service, guaranteeing physical delivery, thus facilitating trades.

Regarding O'Brien's delisting, PG&E explained in the data response that O'Brien is effectively opting out of trading with PG&E because PG&E employs a "buy and hold to expiration trading strategy", generating a relatively small amount of fees for an FCM.

In AL 3492-E, PG&E proposes updates to its Electricity and Gas Hedging Plan to: "(1) to provide adequate flexibility under the current market conditions to maintain PG&E's ability to operate within its hedging plan and (2) to establish a liquidity management strategy to minimize any potential impact of its electric portfolio hedging activities on PG&E's overall liquidity." Because of the confidential nature of PG&E's filing, the public portion of this resolution will describe only in broad strokes the nature of PG&E's request. A confidential appendix attached to this resolution describes PG&E's proposed changes to its Hedging Plan in greater detail.

For the first objective, PG&E is proposing to modify the circumstances in which it will engage in hedging activity and modify the strategy determining the mix of different types of hedging instruments. For the second objective, PG&E is proposing a set of protocols that will guide it as its liquidity position changes.

In addition, PG&E seeks to have the contents of these changes to the Hedging Plan remain confidential for three years following expiration of the last trade executed under this plan. PG&E notes that such treatment would be comparable to that which has already been granted its portfolio in the Department of Water Resources (DWR) contracts.

NOTICE

Notice of ALs 3482-E and 3492-E was made by publication in the Commission's Daily Calendar. PG&E states that a copy of the Advice Letter was mailed and distributed in accordance with Section IV of General Order 96-B to parties shown on a list attached to the advice letters and to the parties on the service list for PG&E's 2007-2016 LTPP, Rulemaking 06-02-013.

PROTESTS

Neither of the advice letters was protested.

DISCUSSION

The Commission has reviewed these advice letters, and will approve them without modification. The changes discussed in AL 3482-E – addition to the list of authorized procurement products, modifications to the list of authorized brokerages and exchanges, and several cosmetic revisions to the LTPP – are important but not fundamental revisions. PG&E has responded convincingly, in person-to-person meetings as well as in data responses, to questions Energy Division staff had about these changes. The revisions should allow PG&E greater flexibility in addressing liquidity and credit issues, should provide greater clarity of their hedging plan, and provide additional options for executing physical and financial trades, without significant new costs or risks.

The changes that PG&E is requesting in its AL 3492-E are more significant. These changes have been thoroughly vetted in meetings both with Energy Division and with PG&E's Procurement Review Group (PRG). Participants in the PRG meetings include Energy Division, the Division of Ratepayer Advocates, The Utility Reform Network (TURN), and the California Department of Water Resources (CDWR). Although these changes to the Hedging Plan are confidential, they have been subjected to review and scrutiny not only by Energy Division but also by the other parties mentioned. We believe that the changes PG&E proposes are reasonable. These changes should help PG&E achieve the two objectives stated in their advice letter, i.e. to provide adequate flexibility under the current market conditions to maintain PG&E's ability to operate within its hedging plan and to establish a liquidity management strategy to minimize any potential impact of its electric portfolio hedging activities on PG&E's overall liquidity

No party has protested either advice letter, and Energy Division staff recommends that they be approved.

We will also approve PG&E's request in AL 3492-E to have the contents of the changes to the Hedging Plan remain confidential for three years following expiration of the last trade executed under this plan. Because the plan encompasses transactions that extend over multiple years, including transactions with expirations more than three years from the effective date of the plan, releasing the plan after three years from its effective date could essentially reveal some information about PG&E's transactions and position as they exist three years hence. This request is similar to PG&E's request in AL 3309-E, which was approved effective October 1, 2008, related to PG&E's gas supply plans for CDWR.

COMMENTS

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to PU Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

FINDINGS

1. Decision (D.) 07-12-052 ordered that all changes to the utilities' Conformed 2006 LTPPs be filed via advice letter.
2. PG&E filed Advice Letter (AL) 3482-E on June 26, 2009.
3. In AL 3482-E, PG&E is requesting: (a) a revision and expansion of its list of authorized procurement products; (b) four additions, one subtraction, and one minor modification to its list of brokerages and exchanges; and (c) associated tariff page changes. No protests to the AL were filed.
4. PG&E filed AL 3492-E on July 10, 2009.
5. In AL 3492-E, PG&E is requesting changes to its confidential Hedging Plan (1) to modify its guidelines for when to hedge, and when not to, and its guidelines regarding product mix, and (2) to provide guidelines in responding to changing liquidity requirements. No protests to the AL were filed.
6. Although the proposed changes detailed in AL 3492-E are confidential, they have been reviewed by PG&E's Procurement Review Group as well as by Energy Division.
7. Energy Division recommends that the Commission approve both these ALs without modification.
8. The contents of the changes to the Hedging Plan proposed with AL 3492-E should remain confidential for three years following expiration of the last trade executed under this plan.

THEREFORE IT IS ORDERED THAT:

1. The request of PG&E to modify its Conformed 2006 LTPP as requested in Advice Letter AL 3482-E is approved.

2. The request of PG&E in AL 3492-E to modify the confidential Hedging Plan associated with its Conformed 2006 LTPP is approved.

This Resolution is effective today.
I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on October 29, 2009; the following Commissioners voting favorably thereon:

/s/ Paul Clanon
Paul Clanon
Executive Director

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