

Decision 04-07-006 July 8, 2004

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Pacific Gas and Electric Company (U 39 G),  
Complainant,

vs.

Calpine Corporation, CPN Pipeline Company  
Calpine Energy Services, L.P., Calpine Natural  
Gas Company; Lodi Gas Storage, LLC; and  
DOES 1-10,

Defendants.

Case 03-07-031  
(Filed July 22, 2003)

**OPINION APPROVING SETTLEMENT**

**I. Summary**

This decision approves a settlement<sup>1</sup> between Pacific Gas and Electric Company (PG&E), complainant, and defendants Calpine Corporation, CPN Pipeline Company (CPN), Calpine Energy Services, L.P., Calpine Natural Gas Company (collectively, Calpine Entities), and Lodi Gas Storage (LGS). The terms of the settlement provide that PG&E will dismiss the complaint in exchange for payments and other agreements by defendants.

We find the settlement meets all of the Commission's requirements, and should be approved.

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<sup>1</sup> The full text of the settlement is attached as the Appendix to this decision.

## **II. Background and Procedural History**

In the complaint, PG&E alleges that LGS is improperly offering the Calpine Entities natural gas transportation services. PG&E claims LGS has a certificate of public convenience and necessity (CPCN) for gas storage services only, and that by offering transportation services LGS is exceeding the authority the Commission granted it in its CPCN.<sup>2</sup> PG&E claims LGS has established direct interconnections between the pipeline the Commission authorized it to install as part of its natural gas storage facilities and CPN's supposedly proprietary natural gas pipeline in an attempt to bypass PG&E's natural gas transportation charges.

PG&E claims that portions of CPN's purported proprietary natural gas pipelines should be treated as public utility services because they are in actuality dedicated to public use. This is because, according to PG&E, CPN is supplying LGS-transported natural gas to Chevron Corporation and to its own Calpine affiliates (Calpine's power plants). PG&E claims doing so is enough to transform Calpine into a public utility operating in PG&E's territory. However, claims PG&E, PG&E has a Commission-mandated monopoly on such services in its territory, and Calpine is acting in violation of law by bypassing PG&E's natural gas transportation network. Moreover, PG&E claims, Calpine is evading local transmission and customer access and customer class charges for natural gas consumed in PG&E's service area. PG&E seeks reparations from both LGS and the Calpine Entities.

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<sup>2</sup> Decision (D.) 00-05-048.

LGS claims it is furnishing Calpine natural gas storage services in compliance with its CPCN. Calpine claims it is not a public utility, but rather a private entity using its own proprietary pipeline to deliver natural gas to its own plants after it receives the natural gas out of storage from LGS. Therefore, both defendants claim, they owe PG&E nothing, as they are not unlawfully bypassing PG&E's natural gas system.

In the October 24, 2003 scoping memo for the proceeding, the Assigned Commissioner and Administrative Law Judge (ALJ) determined that hearings would be necessary<sup>3</sup> and that the proceeding would require determination of the following issues:

- Whether the facilities of Calpine Corporation, CPN, Calpine Energy Services, L.P., Calpine Natural Gas Company, or LGS identified in the complaint constitute facilities for the transportation rather than storage of natural gas;
- Whether LGS violated the terms of its CPCN or Commission-approved tariff by offering transportation rather than storage of natural gas;
- Whether LGS's CPCN allows interconnection with a Calpine Entity;
- Whether any Calpine Entity has dedicated the gas pipeline(s) identified in the complaint to public use, rendering any such Entity a public utility;
- If any Calpine Entity is a public utility, what course of action the Commission should take;

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<sup>3</sup> While this case was classified as adjudicatory and set for hearing, no evidentiary hearing was held so we are no longer governed by the provisions of Article 2.5.

- Whether any Calpine Entity unlawfully bypassed PG&E's system and failed to pay applicable tariff rates to the utility;
- Whether LGS was required to seek review under the California Environmental Quality Act (CEQA) prior to constructing or allowing construction of portions of or appurtenances to the natural gas pipelines identified in the complaint;
- Whether the LGS/Calpine interconnection(s) are authorized by the Commission as permissible under Pub. Util. Code § 1001;
- A detailed calculation of any reparations claimed;
- If reparations are awarded, how they should be divided between ratepayers and shareholders; and
- Whether applicable statutes of limitations bar any portion of the claimed reparations under the facts of this case.

The scoping memo also directed the parties to meet and confer and explore settlement of the case. Shortly after issuance of the scoping memo, the parties announced they had reached a settlement of the case. The ALJ held a prehearing conference on January 15, 2004 to discuss what the settlement entailed, and ordered the parties to follow the Commission's Rule 51 settlement process.

In compliance with the ALJ's order and Rule 51, the parties held a settlement conference on January 26, 2004, to which all parties were invited. At the settlement conference, the settling parties discussed all aspects of the settlement, including how the settlement proceeds would be distributed among PG&E's residential and business ratepayers and its shareholders.

On February 6, 2004, again in compliance with Rule 51, PG&E and defendants filed a joint motion for approval of the settlement.<sup>4</sup> The Utility Reform Network (TURN), Wild Goose Storage Inc. (Wild Goose), Duke Energy North America (Duke), and the California Natural Gas Producers Association (CNGPA) each filed timely comments in March 2004 in support of the proposed settlement. No party opposed the settlement.

### **III. Description of Settlement**

#### **A. General Settlement Provisions**

The proposed settlement agreement (Agreement) provides the following:

- Settlement Proceeds. PG&E will receive \$2.7 million (the “Settlement Proceeds”), which Settlement Proceeds includes both PG&E’s attorneys’ fees in an amount not to exceed \$500,000, and interest. [¶ 3.]<sup>5</sup>
- Suspension of CPN Pipeline Interconnections with LGS. The interconnections between the Calpine Entities and LGS will be rendered inoperable for a moratorium period of nine months, unless otherwise authorized by the CPUC. At the end of that nine-month period, if there still is no authorization by the CPUC, then LGS shall provide PG&E with written notification prior to commencement of any construction activity for installation of new interconnections or the renewed operation of the existing interconnections. PG&E reserves all rights concerning any such future actions taken by LGS. [¶¶ 4 and 7.]
- Ryer Island Meter Station Deliveries. The Calpine Entities are not currently delivering or selling natural gas

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<sup>4</sup> *Joint Motion for Approval of Settlement and Proposal by [PG&E] for Allocation of Settlement Proceeds*, filed Feb. 6, 2004 (Joint Motion).

<sup>5</sup> Paragraph numbers refer to the Agreement.

to, or exchanging natural gas with, any third party at the Ryer Island Meter Station.<sup>6</sup> In the event the Calpine Entities intend to recommence such activity, the Calpine Entities shall provide PG&E with written notice at least thirty-five days before the commencement of natural gas deliveries. The Settlement Agreement builds in a two-step notice procedure for PG&E to either consent or object to this activity. If PG&E objects, the Calpine Entities shall not make Ryer Island Meter Station deliveries without prior CPUC or court approval or a finding that such approval is not necessary. [¶ 5.]

- No Admission of Wrongdoing. The Settlement Agreement and its terms shall not constitute nor be taken to indicate an admission of liability or wrongdoing by any party, or that any party's position on any issue lacks merit. [¶ 11.]
- Effective Date of Provisions. Some of the terms of the Settlement Agreement, such as the Payment noted above, are not effective until issuance of a final CPUC approval; other terms, such as Suspension of CPN Pipeline Interconnections with LGS and no resumption of Ryer Island Meter Station deliveries, were effective immediately upon execution of the Settlement Agreement but are null and void if final CPUC approval is not obtained.
- Dismissal of Complaint. The Settlement Agreement provides that, upon its approval by the CPUC, the CPUC shall also concurrently order the dismissal of the Complaint with prejudice. [¶ 6.]

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<sup>6</sup> In the complaint, PG&E claims that if the Calpine Entities were making such deliveries, such action would be evidence that Calpine was acting as a public utility involved in the transportation of natural gas. In approving the settlement we state no opinion on PG&E's claim, or Calpine's response denying that such action, even if occurring, would render it a public utility.

- Releases and Reservation of Rights. Upon approval of the Settlement Agreement by the CPUC, releases by each of the parties of the claims raised in the Complaint will become effective, subject to certain specified reservations of rights. Among them, PG&E reserves its rights to pursue (1) claims that relate to use of any interconnections to LGS without prior CPUC approval after the Effective Date, (2) claims of unauthorized public utility activities against the Calpine Entities and/or LGS in a new proceeding with respect to matters not raised in the Complaint, and (3) claims with respect to a change in the facts and circumstances relating to alleged unauthorized public utility activity from those facts and circumstances existing as of the Effective Date. The Settlement Agreement also specifies certain reservations of rights by the Calpine Entities and by LGS. Additionally, the Settlement Agreement does not preclude the Settlement Parties' respective rights to advance whatever position they desire before the CPUC on the policy issues relating to third party storage interconnections, or any other issues. [¶¶ 7, 8 and 9.]
- CPUC Approval. The Settlement Parties agree to cooperate fully in the timely preparation and filing of this joint motion for approval of the Settlement Agreement and dismissal of the Complaint with prejudice. If the CPUC approves the Settlement with modifications to the Settlement Agreement, and if a party decides in its sole discretion that the modifications are unacceptable, the Settlement Parties agree to negotiate in good faith to revise the Settlement Agreement in a manner that is acceptable to all Settlement Parties and designed to receive CPUC approval. [¶ 6.]
- PG&E's Proposal on Allocation of Settlement Proceeds.<sup>7</sup> The joint motion for CPUC approval of the Settlement

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<sup>7</sup> We discuss allocation in more detail below.

Agreement includes a proposal for allocation of Settlement Proceeds. With respect to the proposal for allocation of Settlement Proceeds, PG&E is exclusively responsible for the preparation of and the sole sponsor of this section of the motion. The Calpine Entities and LGS will not oppose PG&E's proposal on allocation of Settlement Proceeds, and shall remain neutral and express no opinion or position thereon. [¶ 6.]

### **B. Allocation of Settlement Proceeds**

PG&E alone sponsors the portion of the motion relating to allocation of the settlement proceeds. PG&E describes the process as a mechanical allocation of the settlement proceeds into the applicable rate components, consistent with the accounting rules established in PG&E's tariffs. PG&E's design is to have the proceeds flow to Commission-adopted tariff rate components as if the alleged activities had not occurred, and PG&E, its ratepayers, and the cities and counties for which PG&E collects franchise fees charges, and franchise fee surcharges under Schedule G-SUR are compensated accordingly.

The settlement amount of \$2.7 million is first adjusted by \$278,749, representing actual outside attorneys' fees for PG&E up to December 18, 2003. From the net proceeds of \$2.421 million, PG&E's core (residential and small business) customers will receive \$81,372 and its non-core (large business) customers will receive \$176,081. PG&E's shareholders will receive the remaining "non-protected" settlement proceeds of \$1,666,927.

PG&E explains the calculation in detail. The net proceeds of \$2.421 million were allocated 50 percent, or \$1,210,626, to the alleged activity related to the Ryer Island Meter Station, and 50 percent to the alleged activity at Interconnections A and B, as those terms are defined in the complaint. According to PG&E, this



allocation is based on a reasonable approximation of the alleged shortfall that occurred for each type of activity.

PG&E then used the applicable Rate Schedules to allocate the Settlement Proceeds. For activity related to the Ryer Island Meter Station, PG&E deemed *Schedule G-NT – Gas Transportation Service to Noncore End Use Customers* to be the applicable schedule, since industrial plants are the predominant facilities in this area. With respect to Interconnections A and B, PG&E relied on *Gas Schedule G-EG – Gas Transportation Service to Electric Generators*, because electric generation plants are the facilities downstream of these interconnections. PG&E further assumed the use of the Silverado Path for backbone service under *Schedule G-AA – As Available Transportation On-System*, and the calculation of monthly franchise fee surcharges under *Schedule G-SUR – Customer Procured Gas Franchise Fee Surcharge*.

PG&E developed a spreadsheet listing all applicable rate components in effect for each month of the alleged activity. It calculated a simple average for the period that the alleged activity occurred for each applicable rate component. It allocated the proceeds on a pro rata basis to each rate component based on their proportionate share of each applicable total rate.

With respect to the \$1,210,626 that PG&E allocated to the alleged activity at the Ryer Island Meter Station, the revenue-protected costs – those subject to balancing account treatment and allocable to ratepayers – are \$81,372 to core and \$163,648 to noncore customers. The non-protected costs, or those allocable to PG&E's shareholders, are \$753,667. The franchise fees and G-SUR charges allocated to cities and counties are \$188,560, and the CPUC fees are \$23,380.

With respect to the \$1,210,626 that PG&E allocated for the alleged activity at Interconnections A and B, there are \$12,433 revenue protected costs for

noncore, but none for core customers, since schedule G-EG is exempt from Public Purpose Program surcharges. The non-protected costs are \$916,260. The franchise fees and G-SUR charges to cities and counties are \$229,730, and the CPUC fees are \$52,203.

In total, the revenue-protected costs allocated to ratepayers are \$81,372 to core customers, and \$176,081 to noncore customers. The non-protected costs allocated to PG&E's shareholders are \$1,669,927. The franchise fees and G-SUR charges allocated to cities and counties are \$418,289, and the CPUC fees are \$75,582.

Once PG&E receives the settlement proceeds, PG&E will credit the revenue-protected portion (\$257,453) to the appropriate gas balancing accounts for each of the rate components, which accrue interest until rates are adjusted in the next appropriate gas proceeding or true-up filing. Once the applicable rate component is determined, the settlement proceeds will be flowed through as if they were billed at the time of the alleged activity, using simple averaged rates.

#### **IV. Discussion**

In order for a settlement to be approved by the Commission, the settlement must be: (1) reasonable in light of the whole record, (2) consistent with law, and (3) in the public interest. Rule 51.1(e).<sup>8</sup>

##### **A. Reasonableness in Light of the Whole Record**

The settlement addresses all pertinent issues raised in the complaint, without establishing broad policy that might affect parties not named in the

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<sup>8</sup> All rule citations are to the Commission Rules of Practice and Procedure, unless otherwise specified.

complaint. Thus, the settlement entirely disposes of the claims PG&E raises against defendants, but has no impact on issues of broader scope. It is appropriate that the settlement here addresses only the dispute between PG&E and defendants, rather than broader issues related to gas transportation generally.

All parties that filed comments support the settlement. For example, TURN states that the Agreement meets the “reasonable in light of the whole record” standard based on TURN’s review of the Agreement and PG&E’s agreement to share with the Commission, TURN, and the Office of Ratepayer Advocates (ORA) any notices it receives from defendants pursuant to the Agreement. It states that it has discussed the Agreement in some detail with the settling parties, and has reviewed certain confidential materials provided in the context of the settlement negotiations. It finds that the “settlement is a reasonable compromise of strongly held positions.” TURN agrees that “preserving the larger policy issues for resolution in a forum more conducive to broad public participation than a complaint proceeding serves the public interest.” Finally, TURN states that it has “reviewed PG&E’s proposed allocation of the settlement proceedings and consider[s] it reasonable given the modest amounts involved.”<sup>9</sup>

Wild Goose also supports the Agreement because it only resolves historic claims between PG&E and the named defendants, rather than prejudging what its claims are broader policy issues raised by the complaint. Wild Goose states that

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<sup>9</sup> *Comments of [TURN] in Support of the Proposed Settlement*, filed March 8, 2004 (TURN Comments), at 2.

it intervened in the proceeding because of its concern that the relief sought by PG&E in the complaint “had ramifications which would extend far beyond the named parties.” Whether or not this is true, Wild Goose’s support of the Agreement constitutes an acknowledgment that the settlement resolves only those issues between PG&E and the defendants, without creating impacts for “other participants in the natural gas industry. . . .”<sup>10</sup>

Duke essentially echoes Wild Goose’s stance, noting that the settlement “is a reasonable compromise of the parties’ interests [that] gives the parties an opportunity to pursue further resolution of some of the underlying issues, without unduly restricting the parties’ rights to pursue their interests in proceedings before the Commission.”<sup>11</sup>

Finally, CNGPA similarly supports the settlement because it “resolves factual issues regarding the relationship between the parties to the Settlement Agreement . . . but leaves resolution of broader, industry-wide, issues to other proceedings where a broader array of parties can participate and assist the Commission in determining the public interest with respect to those industry-wide policy issues.”<sup>12</sup>

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<sup>10</sup> *Comments of Wild Goose Storage Inc. on Joint Motion for Approval of Settlement and Proposal by [PG&E] for Allocation of Settlement Proceeds*, filed March 5, 2004 (Wild Goose Comments), at 1-2.

<sup>11</sup> *Comments of Duke Energy North America on Proposed Settlement*, filed March 8, 2004, at 1.

<sup>12</sup> *Response of [CNGPA] in Support of Joint Motion for Approval of Settlement*, filed March 8, 2004, at 2.

Thus here, as in D.03-04-007,<sup>13</sup> the Settlement Agreement is very closely based on the record developed by the parties, and is reasonable because it addresses the specific issues raised in the complaint. The settlement is reasonable in light of the whole record.

### **B. Consistent with the Law**

The Settlement Agreement resolves the issues set forth in the complaint and is the product of good faith negotiations between the parties. No party claims that the settlement itself, or the allocation of proceeds, runs counter to law, rule or tariff. We have analyzed the allocation of proceeds and also find the settlement consistent with the law. PG&E correctly represents that the allocation is consistent with its tariffs, and its calculations of volume appear reasonable.

The settlement provides for payment of PG&E's attorneys' fees. We have allowed settlements to include such payment in the past.<sup>14</sup> PG&E's total legal fees amount to \$584,049. However, PG&E has voluntarily agreed to limit its recovery to fees charged by outside counsel through December 18, 2003.<sup>15</sup> These

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<sup>13</sup> In D.03-04-007, the Commission approved a settlement based on the same test we apply here.

<sup>14</sup> *See, e.g.*, D.03-07-032, 2001 Cal. PUC LEXIS 1232, at \*\*8-9 & \*63; D.01-03-078, 2001 Cal. PUC LEXIS 227, at \*9.

<sup>15</sup> PG&E voluntarily agreed to forego recovery of its in-house counsel fees. In PG&E's letter dated April 26, 2004 documenting its fee claim, PG&E stated the following: "In our case, even though Defendants agreed to pay PG&E's attorneys' fees in an amount not to exceed \$500,000, PG&E volunteered to be reimbursed only for its outside counsel fees. In addition, while PG&E continues to incur legal fees, PG&E voluntarily limited its recovery of fees to those incurred by the time the parties settled in principle, on December 18, 2003. . . . By voluntarily limiting its recovery of fees to only outside

*Footnote continued on next page*

fees total \$278,749. We approve the settlement agreement's payment of PG&E's outside counsel fees.

Thus, here, as in D.03-04-007, we conclude that the settlement is consistent with the law.

**C. In the Public Interest**

The Commission has up until now limited the transmission of natural gas to monopoly energy providers such as PG&E. The settlement preserves this

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counsel and only through December 18th, PG&E reduced its recovery by more than half, to \$278,749."

*status quo* while not affecting how the Commission might address this issue in the future.

For these reasons, the Commission finds that the settlement is reasonable in light of the whole record, is consistent with the law, and is in the public interest. We note that nothing in the Agreement binds the Commission or should be construed to constitute a Commission statement of policy on the conduct alleged in the complaint. The Commission is free in the future to interpret the conduct alleged in the complaint, or like conduct, as it sees fit, consistent with the law.

The settlement should be approved.

## **V. Comments on Draft Decision**

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure. TURN and PG&E filed comments and PG&E filed reply comments.

PG&E claims that draft decision erred in finding that PG&E should not be allowed to recover its in-house counsel attorneys' fees in the amount of \$305,300 in any Commission proceeding. PG&E reasons that "California utilities such as PG&E play a critical role in supporting efforts by this Commission and the State of California to prosecute complaints against entities in the wholesale and upstream energy markets whose illegal activities have resulted in harm to the customers of the utilities."<sup>16</sup> (We do not express an opinion on whether PG&E

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<sup>16</sup> PG&E Comments at 5, citing *Public Utilities Commission of the State of California v. El Paso Natural Gas Co, et al.*, FERC Docket No. RP00-241-000, 105 FERC ¶ 61,201

*Footnote continued on next page*

played such a role in this case, as defendants make no admission of liability in the Settlement Agreement.) PG&E also claims that the Commission has not disallowed recovery of in-house attorneys' fees in other cases, and that recovery of a portion of the fees from the settlement proceeds benefits ratepayers and should not preclude recovery of the remaining fees.

On consideration of PG&E's comments, we believe PG&E is correct that it did not forego its right to recover its in-house fees from ratepayers by discounting the outside counsel fees charged to the settlement proceeds. We change the draft decision to reflect our conclusion.

TURN's comments point out that its support for the settlement was conditioned on PG&E's agreement to share with TURN, ORA and the Commission any notices it receives from defendants pursuant to the settlement. TURN asks us to reflect this condition in the discussion of TURN's support for the Agreement. PG&E supports TURN's request. We modify the decision as TURN requests.

## **VI. Assignment of Proceeding**

Geoffrey Brown is the Assigned Commissioner and Sarah R. Thomas is the assigned ALJ in this proceeding.

## **Findings of Fact**

1. The settlement only resolves issues raised in the complaint, and leaves issues of broader policy impact for later resolution.
2. All parties support the settlement.

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(Nov. 14, 2003), *reh'g denied*, 106 FERC ¶ 61,315 (U.S. Court of Appeals for the D.C. Circuit, petition for review filed April 9, 2004).



3. The settlement does not preclude future Commission action.
4. The allocation of the settlement proceeds is consistent with PG&E's tariffs.
5. Hearings are not necessary.

### **Conclusions of Law**

1. The settlement is reasonable in light of the whole record.
2. The settlement is consistent with the law.
3. The settlement is in the public interest.
4. The settlement should be approved.

## **O R D E R**

### **IT IS ORDERED** that:

1. The Joint Motion for Approval of Settlement and Proposal by Pacific Gas and Electric Company for Allocation of Settlement Proceeds is approved.
2. The settlement proceeds shall be distributed as set forth in the Settlement Agreement, attached as the Appendix to this decision.
3. Nothing in the Agreement binds the Commission or should be construed to constitute a Commission statement of policy on the conduct alleged in the complaint. The Commission is free in the future to interpret the conduct alleged in the complaint, or like conduct, as it sees fit, consistent with the law.
4. Hearings shall not occur in this proceeding.

This order is effective today.

Dated July 8, 2004, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
CARL W. WOOD  
LORETTA M. LYNCH

GEOFFREY F. BROWN  
SUSAN P. KENNEDY  
Commissioners

## **APPENDIX A**

### **SETTLEMENT AGREEMENT AND RELEASE**

This Settlement Agreement and Release (including all mutually agreed upon written amendments and modifications by the parties, hereinafter referred to as the “Agreement”) is made effective as of January 15, 2004, (the “Effective Date”), by and between Pacific Gas and Electric Company (“PG&E”), complainant, and Calpine Corporation on behalf of itself and Calpine Natural Gas Company, which was merged into Calpine Corporation on April 24, 2002, CPN Pipeline Company (“CPN Pipeline”), and Calpine Energy Services, L.P. (collectively the “Calpine Entities”), and Lodi Gas Storage, L.L.C. (“LGS”), defendants. “Party” means and refers to PG&E, the Calpine Entities or LGS, individually. “Parties” means and refers to PG&E, the Calpine Entities and LGS, collectively.

### **RECITALS**

A. On July 22, 2003, PG&E initiated a complaint proceeding against the Calpine Entities and LGS before the California Public Utilities Commission (the “CPUC”), designated as Case No. C.03-07-031 (the “Complaint”). The Calpine Entities and LGS timely answered the Complaint, each respectively disputing PG&E’s claims of any right to relief, and the Parties have thereafter been engaged in the litigation of the Complaint.

B. The Parties now wish to settle, compromise and resolve all claims between and among them, pertaining to the claims and issues contained in the Complaint in accordance with Rule 51, *et seq.*, of the CPUC Rules of Practice and Procedure.

THEREFORE, in consideration of the mutual terms, obligations, covenants, conditions and promises contained herein, the Parties agree as follows:

1. Provisions Effective as of Effective Date

This Agreement shall be effective as of the Effective Date.

2. Stay of Litigation Schedule

The Parties shall at the prehearing conference, now scheduled for January 15, 2004, jointly renew their request that the Assigned Administrative Law Judge stay the litigation schedule in the Complaint proceeding, including discovery, depositions, filing of testimony and motions, pending the filing of a motion for approval and CPUC approval of this Agreement.

3. Payment

Within five (5) business days after satisfaction of the CPUC Approval Condition Precedent, as defined in Paragraph 6 of this Agreement, PG&E shall be paid by wire transfer the total aggregate sum of \$2.7 million (the "Settlement Proceeds"), which Settlement Proceeds shall be deemed to include both PG&E's attorneys' fees in an amount not to exceed \$500,000,

and interest. In the event payment of the full Settlement Proceeds is not made by wire transfer within such five-day period, PG&E reserves its full rights under law to offset up to the full amount, including interest at the then current FERC approved rate (18 CFR part 35, section 35.19a) commencing at the end of the fifth day, of any outstanding Settlement Proceeds from any present or future payments PG&E may otherwise be obligated to make.

4. Suspension of CPN Pipeline Interconnections with LGS

Within five (5) business days from the Effective Date, the Calpine Entities and LGS shall render inoperable the existing interconnections between CPN Pipeline and LGS, identified in the Complaint as Interconnections A and B, and further shall refrain from operating the CPN Pipeline interconnections pending either a future CPUC order, decision, resolution or pronouncement issued in accordance with the provisions set forth in Paragraph 7, or the expiration of the nine (9) month specified in Paragraph 7. If the CPUC Approval Condition Precedent is deemed not capable of satisfaction as provided for in Paragraph 6 of this Agreement, this Paragraph 4 shall be deemed null and void.

5. Ryer Island Meter Station Deliveries

- a. The Calpine Entities are currently not delivering or selling natural gas to, or exchanging natural gas with, any third party at the Ryer Island Meter Station. In the event that the Calpine Entities intend to commence delivering or selling natural gas to, or exchanging natural gas with, any third party at the Ryer Island Meter Station ("Intended Ryer Island Meter Station Delivery"), the Calpine Entities shall provide PG&E written notice of, and describe, the intended transaction no later than thirty-five (35) calendar days before the commencement of any natural gas deliveries. The Calpine Entities shall not commence the Intended Ryer Island Meter Station Delivery unless and until PG&E provides a written consent, or is deemed to have consented pursuant to subparagraph 5(c), or if the Calpine Entities obtain the applicable authorization pursuant to subparagraph 5(d). Such notice by the Calpine Entities of the Intended Ryer Island Meter Station Delivery shall identify the third party, quantify the volumes of natural gas to be delivered, and specify the facilities through which the third party shall have its natural gas delivered downstream of the Ryer Island Meter Station.
- b. PG&E has ten (10) calendar days from the date that the Calpine Entities provide notice to it of the Intended Ryer Island Meter

Station Delivery to respond. If PG&E does not, within the ten (10) period, provide a written consent to the Calpine Entities, or does not make any response whatsoever, then PG&E shall be deemed to have objected to the Intended Ryer Island Meter Station Delivery. PG&E may also, within the ten (10) day period, provide a written objection.

- c. If PG&E is deemed to have objected to the Intended Ryer Island Meter Station Delivery, pursuant to subparagraph 5(b), then the Calpine Entities may, within ten (10) calendar days of such objection, request in writing that PG&E make a written response setting forth the basis of its objection, if PG&E has not already done so. PG&E will, within ten (10) calendar days of receipt of the written request from the Calpine Entities for such a response, provide a written statement setting forth the basis for its objection to the Intended Ryer Island Meter Station Delivery. If PG&E does not provide such written response within ten (10) calendar days, then PG&E shall be deemed to have provided its written consent, and the Calpine Entities may proceed with the Intended Ryer Island Meter Station Delivery.
- d. The Calpine Entities reserve their respective rights at any time to obtain an order or other authorization by the CPUC, or a court,

either authorizing the Calpine Entities to engage in the Intended Ryer Island Meter Station Delivery, or finding that the Calpine Entities need no prior governmental authorization to engage in the Intended Ryer Island Meter Station Delivery.

- e. If the CPUC Approval Condition Precedent is deemed not capable of satisfaction as provided for in Paragraph 6 of this Agreement, then this Paragraph 5 shall be deemed null and void.

6. CPUC Approval Condition Precedent

- a. The Parties shall cooperate fully in the timely preparation and filing of a joint motion for approval of the settlement of the Complaint, for the approval of the terms and conditions of this Agreement, and for the concurrent dismissal of the Complaint with prejudice. The joint motion shall contain as a separate section a proposal by PG&E for the allocation of the Settlement Proceeds with respect to ratepayers, PG&E shareholders and/or governmental entities; this separate allocation section shall be prepared by and offered by PG&E exclusively. The Calpine Entities and LGS acknowledge and agree that the proposal that PG&E will offer for the allocation of the Settlement Proceeds with respect to ratepayers, PG&E shareholders, and/or governmental entities shall be determined by, and shall be



the sole responsibility of, PG&E. Consequently, the Calpine Entities and LGS will not oppose directly or indirectly PG&E's proposed or actual allocation of the Settlement Proceeds, and shall remain neutral and express no opinion or position thereon. The Parties shall fully support approval by the CPUC of the terms and conditions of this Agreement and the dismissal of the Complaint with prejudice. Each Party shall bear its own costs in the preparation and prosecution of the joint motion.

- b. The effectiveness of Paragraphs 3, 7, 8 and 9 of this Agreement is expressly subject to a condition precedent of approval of this Agreement and the dismissal of the Complaint with prejudice by the CPUC ("CPUC Approval Condition Precedent"). The CPUC Approval Condition Precedent shall be satisfied by any, and upon the earlier of, the following:
  - i. The CPUC approving the Agreement and dismissing the Complaint with prejudice with no required modifications or conditions to the Agreement;
  - ii. No Party serving a timely Notice of Unacceptable Modification as provided for in subparagraph 6(d); or

- iii. The Parties, in accordance with the procedures set forth in subparagraph 6(d), renegotiating the Agreement, the CPUC approving (directly or indirectly) the renegotiated Agreement, and the Complaint being dismissed with prejudice.
- c. In the event the CPUC issues a decision rejecting the settlement on the terms of this Agreement (“Adverse CPUC Decision”), the Parties will meet and confer within five (5) business days to seek agreement on steps regarding the Agreement and the Adverse CPUC Decision. Absent any such agreement among the Parties to continue to seek approval of this Agreement, the CPUC Approval Condition Precedent shall be deemed not capable of satisfaction.
- d. If the decision by the CPUC would approve the Agreement and dismiss the Complaint with prejudice upon the condition(s) that the Parties modify the Agreement, and if a Party determines, in its sole discretion, that such required modification(s) is (are) unacceptable, that Party shall notify the other Parties within five (5) business days after the CPUC mailing of the decision that the decision contains a modification or condition unacceptable to the notifying Party (“Notice of Unacceptable Modification”). Upon delivery of a Notice of Unacceptable Modification, the Parties agree to negotiate in good

faith to revise the Agreement in a manner that is acceptable to all Parties and designed to receive CPUC approval. If the Parties are able to renegotiate the terms of this Agreement and the CPUC approves (directly or indirectly) the renegotiated Agreement, the CPUC Approval Condition Precedent shall be deemed satisfied.

- e. In the event that the Parties are not able to renegotiate this Agreement by the earlier of ten (10) business days following the sending of a Notice of Unacceptable Modification (provided the Parties may extend this period upon mutual written agreement), or two (2) business days before any deadline the CPUC may impose in its decision for the Parties to accept any modifications to this Agreement, then the CPUC Approval Condition Precedent shall be deemed not capable of satisfaction. In such event, the Parties' respective rights and obligations set forth in this Agreement shall be rendered null and void.
- f. If the decision by the CPUC would approve the Agreement and dismiss the Complaint with prejudice only upon the condition(s) that the Parties modify the Agreement, and if no Party serves a timely Notice of Unacceptable Modification, each Party shall be deemed to have waived its respective rights to assert that the CPUC

decision contains an unacceptable modification or condition, the Parties shall provide the CPUC any required notice of their acceptance of the Agreement as modified by the CPUC, and the CPUC Approval Condition Precedent shall be deemed satisfied.

7. Future CPUC Proceedings

- a. For a period of nine (9) months from the Effective Date, LGS shall do nothing to render Interconnections A or B operable, or to operate said interconnections, or to install or allow to be installed any other interconnections; provided that, if the CPUC Approval Condition Precedent is deemed not capable of satisfaction as provided for in Paragraph 6, this Paragraph 7 shall be deemed null and void. If, at the conclusion of such nine (9) month period, the CPUC has not issued any order, decision, resolution or pronouncement effectively authorizing interconnections by LGS, then LGS shall first notify in writing PG&E's Vice President of California Gas Transmission prior to commencement of any construction activity for new interconnections that LGS may install or the renewed operation of Interconnection A or B. PG&E reserves all rights concerning any actions taken by LGS after the expiration of the nine (9) month period described in this subparagraph 7(a) to render

Interconnections A or B operable or to interconnect with any other third party.

- b. There is now pending before the CPUC a petition for rulemaking in Case No. P.03-10-046, seeking the establishment of rules governing (i) interconnection of independent storage operators, including among others LGS, with third parties other than incumbent utilities such as PG&E; and (ii) the nature and types of services the independent storage providers can provide to customers through such third-party interconnections. In that or any other proceeding or noticed activity before the CPUC, including, but not limited to, any application by LGS to amend its certificate of public convenience and necessity or to amend its tariffs, each Party reserves the right to advance any proposals or positions that such Party desires to advance. This reservation of rights includes, but is not limited to, the right of any Party to seek or oppose conditions on third party interconnections, and the right of PG&E to file a new complaint in the event that LGS elects to proceed with construction of an interconnection without CPUC authorization after expiration of the nine-month period provided for in Paragraph 7(a) above.

8. PG&E Release of Claims

In consideration of the payments and promises contained in this Agreement and effective upon the satisfaction of the CPUC Approval Condition Precedent, PG&E and its respective agents, officers, employees, attorneys, representatives, successors, affiliates, parents, subsidiaries and assigns, and each and all of them, relinquish, release, waive, quit and forever discharge the Calpine Entities, individually and collectively, and LGS, and each of their respective agents, officers, employees, attorneys, representatives, successors, affiliates, parents, subsidiaries and assigns, and each and all of them, from any and all claims that PG&E has, had or may have for damages, costs, expenses, restitution, reparations, liabilities, attorneys' fees, demands, debts, and causes of action, whether actual or contingent, legal or equitable, known or unknown of any kind or nature whatsoever against the Calpine Entities and/or LGS, and each of their respective agents, officers, employees, attorneys, representatives, successors, affiliates, parents, subsidiaries and assigns as of, or prior to, the Effective Date, which relate to the allegations or claims contained in the Complaint. Notwithstanding the foregoing, PG&E reserves all rights: (1) to pursue claims related to use of any interconnections to LGS without prior CPUC approval after the Effective Date, (2) to pursue any claim of unauthorized public utility activity against the Calpine Entities and/or

LGS in a new proceeding with respect to matters not raised in the Complaint, or (3) to pursue claims with respect to a change in the facts and circumstances relating to alleged unauthorized public utility activity from those facts and circumstances existing as of the Effective Date. PG&E agrees that, prior to filing any new complaint based upon such a change in facts and circumstances, PG&E shall first meet and confer in good faith with the Calpine Entities and/or LGS in an effort to resolve any dispute.

9. Release by LGS and the Calpine Entities

In consideration of the promises contained in this Agreement, the Calpine Entities and LGS, and each of them, and their respective agents, officers, employees, attorneys, representatives, successors, affiliates, parents, subsidiaries and assigns and each and all of them relinquish, release, waive, quit and forever discharge PG&E and its respective agents, officers, employees, attorneys, representatives, successors, affiliates, parents, subsidiaries and assigns and each and all of them from any and all claims that the Calpine Entities and LGS, and each of them, have, had or may have for damages, costs, expenses, liabilities, attorneys' fees, demands, debts, and causes of action, whether actual or contingent, legal or equitable, known or unknown, of any kind or nature whatsoever against PG&E and its agents, officers, employees, attorneys, representatives,

successors, affiliates, parents, subsidiaries and assigns, which would be within the jurisdiction of a state or federal court for civil damages or equitable relief arising from and directly related to the facts alleged by PG&E in the Complaint with respect to unauthorized public utility activity; the natural gas deliveries that the Calpine Entities made to the Ryer Island Meter Station; and Interconnections A and B between the Calpine Entities and LGS, including but not limited to the act of interconnecting, the construction and operation of the interconnections, and the natural gas that flowed through them. This release specifically does not release, preclude or limit in any manner whatsoever any claim, action, contention, argument or advocacy position that the Calpine Entities or LGS, and each of them, make or wish to make in any future hearing, proceeding, investigation or matter involving PG&E at the CPUC, or any other regulatory, administrative or legislative forum; provided further that the Calpine Entities and LGS reserve their respective rights to pursue any claim against PG&E before any court or agency of competent jurisdiction arising from or relating to matters not raised in the Complaint or with respect to a change in the facts and circumstances from those existing as of the Effective Date.



10. Release of Unknown Claims

Each of the Parties to this Agreement represents and agrees that it has read and fully understands California Civil Code § 1542, which provides as follows:

A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.

Each of the Parties expressly and specifically waives any and all the rights and/or remedies provided by such statute, whether known or unknown; provided that the Parties do not waive those claims, remedies or rights arising after the Effective Date, or expressly reserved or retained, or not released, by the Parties pursuant to the terms of this Agreement.

11. No Admission of Wrongdoing / Non-Liability for Compliance with Agreement Terms

This Agreement represents a compromise of disputed claims, and this Agreement and its terms shall not constitute nor be taken to indicate an admission of liability or wrongdoing by any Party, or that any Party's position on any issue lacks merit. No Party shall be liable on any claim for damages or other relief based on alleged injury or loss resulting from any Party's compliance with the terms of this Agreement or its operation, in the

event that the CPUC Approval Condition Precedent is not satisfied.

Notwithstanding any other term or condition of this Agreement, this Paragraph 11 shall remain in full force and effect, and shall continue to be binding upon the Parties hereto, after the expiration of the other terms of this Agreement, regardless of the actions or decisions of the CPUC.

12. Governmental Approvals

This Agreement, and the binding effect of it and its terms on each Party, is not conditioned or dependent upon any governmental or other regulatory approval, except to the extent that this Agreement is subject to the CPUC Approval Condition Precedent, in accordance with the terms contained in Paragraph 6.

13. Entire Agreement

Each of the undersigned Parties understands and agrees that this Agreement contains the entire agreement between and among the Parties hereto with respect to the subject matter of this Agreement; and that the terms of the Agreement supersede any prior discussions, oral understandings, oral agreements or written documents between or among any of the Parties relative to the subject matter hereof. The terms of this Agreement are intended to constitute a binding contract between and among the Parties for the express benefit of those Parties, and this

Agreement is not based on any representations, conditions or understandings not contained in this Agreement. Any subsequent amendments or changes to this Agreement shall be in writing and signed by the Parties.

14. Each Party Represented by Counsel

Each of the undersigned Parties represents and acknowledges that it has been represented in the negotiations and review of this Agreement by counsel of its choice; it has fully read and understood the terms of this Agreement, and has had the opportunity for the full legal effect and consequences of this Agreement to be explained by its counsel.

15. Rule of Construction

Each of the undersigned Parties and their attorneys have reviewed this Agreement and agree that any legal rule of construction or interpretation to the effect that ambiguities or uncertainties in written instruments are to be resolved against the drafting Party shall not apply to the construction or interpretation of this Agreement.

16. Benefit of Parties

All representations, covenants, obligations and agreements contained in this Agreement shall be binding upon and inure to the benefit of the Parties, and their respective successors and assigns.

17. Agreement Voluntary

Each of the undersigned Parties represents and agrees that this Agreement has been entered into voluntarily and free from duress or undue influence on the part of any other Party to, or any person released by, this Agreement, or any third party.

18. Counterparts

This Agreement may be executed in one or more counterparts.

19. Authority

Each Party represents and warrants that it has the authority to enter into and be bound by this Agreement, and that the person executing this Agreement on behalf of each Party is duly authorized to do so. Calpine Corporation has the authority and is signing on behalf of Calpine Natural Gas Company, which merged into Calpine Corporation as of April 24, 2002, and which thus no longer exists.

20. Governing Law

The law of the State of California shall govern any dispute relating to this Agreement.

21. Notices

- a. All notices required under the Agreement shall be made to the following:
  - i. For PG&E: Michael Katz (Vice President of California Gas Transmission), or his successor, at the following address: 245 Market Street, N14F, San Francisco, CA 94105, with copy to: Frank Lindh, PG&E Law Department, 77 Beale Street, B30A, San Francisco, CA 94105.
  - ii. For LGS: Thomas R. Dill (President), or his successor, at the following address: 14811 St. Mary's Lane, Suite 150, Houston, TX 77079.
  - iii. For the Calpine Entities: B.A. Berilgen (Executive Vice President of Calpine Corporation) or his successor, at the following address: 717 Texas Avenue, Houston, TX 77002 with a copy to: General Counsel, Calpine Corporation, 50 West San Fernando, San Jose, CA 95113.

**IN WITNESS HEREOF**, each of the undersigned Parties has signed this Agreement on the date indicated herein.

Dated: \_\_\_\_\_ CALPINE CORPORATION

By: \_\_\_\_\_  
Its: \_\_\_\_\_

Dated: \_\_\_\_\_ CPN PIPELINE COMPANY

By: \_\_\_\_\_  
Its: \_\_\_\_\_

Dated: \_\_\_\_\_ CALPINE ENERGY SERVICES, L.P.

By: \_\_\_\_\_  
Its: \_\_\_\_\_

Dated: \_\_\_\_\_ CALPINE NATURAL GAS COMPANY  
by Calpine Corporation

By: \_\_\_\_\_  
Its: \_\_\_\_\_

Dated: \_\_\_\_\_ LODI GAS STORAGE, L.L.C.

By: \_\_\_\_\_ Thomas R. Dill

Its: President

Dated: \_\_\_\_\_ PACIFIC GAS AND ELECTRIC  
COMPANY

By: \_\_\_\_\_  
Its: \_\_\_\_\_

APPROVED AS TO FORM:

Dated: \_\_\_\_\_  
Frank Lindh  
Pacific Gas and Electric Law Department  
Attorneys for Complainant  
PACIFIC GAS AND ELECTRIC  
COMPANY

Dated: \_\_\_\_\_  
Steven F. Greenwald  
Davis Wright Tremaine LLP  
Attorneys for Defendants  
CALPINE CORPORATION,  
CPN PIPELINE COMPANY,  
CALPINE ENERGY SERVICES and  
CALPINE NATURAL GAS COMPANY

Dated: \_\_\_\_\_  
Dan L. Carroll  
Downey Brand LLP  
Attorneys for Defendant  
LODI GAS STORAGE, L.L.C.

