

January 28, 2003

ADVICE 2441-G

Public Utilities Commission of the State of California

Subject: Modification to Core Procurement Incentive Mechanism

Pacific Gas and Electric Company (PG&E) hereby requests approval by the California Public Utilities Commission of a modification to PG&E's Core Procurement Incentive Mechanism (CPIM)¹, to allow PG&E to sell natural gas in California's open wholesale markets,² including PG&E's Citygate market.^{3 4}

Purpose

By a motion filed October 18, 1996, PG&E asked the Commission to supplement PG&E's Gas Accord Application with the Supplemental Report Describing the Post-1997 CPIM.⁵ The report stipulates that PG&E is authorized to sell gas outside California, in both U.S. and Canadian gas markets.⁶ CPIM modifications are permitted pursuant to the Supplemental Report, Section VI, Item F, *Monitoring and Evaluation*, which specifies that PG&E and the Commission's Office of Ratepayer Advocates (ORA) may evaluate PG&E's CPIM in order to ensure its proper function and to determine whether any modifications are appropriate. In light of changes in the California gas market, PG&E proposes the modification described herein as an enhancement to PG&E's CPIM that should benefit PG&E's gas customers and the broader California gas market.

¹ The CPIM tracks PG&E's gas procurement activities. Incentive rewards and penalties are calculated based on commodity and capacity benchmarks. PG&E files monthly and annual reports on gas procurement activities with the CPUC.

² The proposed modification is independent of and does not affect PG&E's current bundled gas procurement and transportation service to its core customers.

³ "Citygate" is any point at which PG&E's California Gas Transmission's backbone transmission system connects to PG&E's local transmission or distribution system. The Citygate market is a theoretical point at which inventories of gas are transferred from sellers to buyers.

⁴ PG&E reserves all legal rights to challenge the decisions or statutes under which it has been required to make this advice filing, and nothing in this advice filing constitutes a waiver of such rights. Also, PG&E reserves any additional legal rights to challenge the requirement to make this advice filing by reason of its status as a debtor under Chapter 11 of the Bankruptcy Code, and nothing in this advice filing constitutes a waiver of such rights.

⁵ The Gas Accord Decision 97-08-055 authorized the CPIM, effective January 1, 1998.

⁶ Section VI (Page 2-14), Additional Features, A. Gas Sales/Capacity Brokering Revenues, states: "In managing its portfolio, PG&E will have the authority to sell gas supplies outside of California and will have the authority to transport that gas prior to sale."

Background

PG&E purchases gas at a number of wholesale markets both outside and inside California to meet forecasts of core loads. PG&E Citygate is among these purchase points. PG&E sometimes experiences situations where it is advisable to sell gas.

One situation in which selling gas is indicated is when PG&E has, based on load forecasts, acquired gas in excess of actual core loads. Currently, PG&E has three ways to manage excess gas: 1) create a pipeline imbalance by bringing on the excess supply, 2) inject the excess supply into storage, or 3) sell gas in authorized markets. Due to contractual and physical limitations for transmission imbalances and storage injection, it is sometimes not operationally feasible or in the ratepayers' best economic interests to run an imbalance or to inject gas into storage.

PG&E also encounters situations in which it is economic to replace current wholesale purchases with less expensive wholesale purchases at another time or location. Such opportunities occur chiefly in the daily swing markets.

In many instances of excess gas it is advantageous to sell. Replacement purchases require the sale of gas by definition. PG&E currently sells gas in Canadian or U.S. interstate markets when these situations arise. However, selling outside California may strand pipeline capacity from the point of sale to Citygate, since it is operationally infeasible to release such capacity on a day-to-day basis. The amount of capacity stranded is a function of the amount of gas sold, which varies depending on load or on the amount of gas available at the better price.

A sale at Citygate would not strand capacity, and would thus maximize recovery of pipeline costs. PG&E's CPIM, however, currently does not allow PG&E to sell wholesale gas in its own service area.⁷ This prohibition is unique to PG&E among major California public utilities. Southern California Gas Company, for instance, may sell gas from its storage fields directly to wholesale market participants within its service territory, and does so routinely. The initial reason that PG&E was prohibited from intrastate gas sales was the concern of the Gas Accord⁸ parties that PG&E's full participation⁹ in the open market might have hindered the emergence of a Citygate market by limiting marketers' opportunities to sell gas in California.

⁷ PG&E is not prohibited from selling gas at the California border and brokering or utilizing PG&E's intrastate capacity, for a fee, to transport that gas to the Citygate on behalf of the purchasing party. PG&E is allowed to sell gas to retail core customers in its service territory.

⁸ PG&E's Gas Accord Application 96-08-043 established unbundled intrastate transportation and storage services, providing more choices to marketers, shippers and end-use customers. The Commission approved PG&E's Gas Accord in Decision 97-08-055, dated August 1, 1997.

⁹ PG&E currently is authorized to purchase gas within California.

Market Changes Compel CPIM Modification

Since 1998, when the Gas Accord established the Northern California market structure, PG&E's Citygate has evolved into a dynamic and liquid marketplace with many buyers and sellers.¹⁰ Marketers who choose not to subscribe to pipeline transportation capacity rely substantially on the Citygate market to meet their gas loads. As indicated in PG&E's Market Conditions Report,¹¹ volumes traded at Citygate often exceed volumes at California border points. The substantial growth and increased levels of activity in PG&E's Citygate market alleviates previous concerns regarding PG&E's full participation in California's open wholesale markets. In fact, many marketers have contacted PG&E to express their keen interest in purchasing wholesale gas directly from PG&E at Citygate. Such sales would improve market liquidity and make additional sources of wholesale gas available, which marketers could in turn sell to their customers.

In addition, the introduction of electronic trading platforms for both physical and financial gas trades at Citygate demonstrates the significance and liquidity of the wholesale California intrastate gas market. The Intercontinental Exchange ("ICE"), an independent electronic trading platform, allows market participants to perform both physical and financial gas trades at Citygate. A second electronic trading platform, Canada's Natural Gas Exchange ("NGX"), has announced expansion plans into U.S. trading points, which include the introduction of a physical trading instrument for the Citygate market.¹² Finally, the New York Mercantile Exchange ("NYMEX") has recently introduced a financial trading instrument for PG&E Citygate. None of the owners of these multi-party electronic trading platforms participate in the markets themselves, but merely provide a clearinghouse for willing buyers and sellers. Thus, they provide unbiased price discovery and transparency, as all buyers and sellers can see the prices simultaneously. If this modification is approved, PG&E proposes to use one or more of these electronic trading platforms as a method to sell wholesale gas at Citygate.

Commission authorization of PG&E's proposal to sell gas in California's open wholesale markets would increase the value core gas ratepayers receive for pipeline capacity by providing an additional market for the sale of gas.¹³ Any revenue from such sales would be credited against gas procurement costs under the CPIM, thus benefiting core ratepayers, and potentially benefiting PG&E's shareholders to the extent a CPIM award is earned.

This filing will not affect any other rate or charge, cause the withdrawal of service, or conflict with any other rate schedule or rule.

¹⁰ ORA and PG&E already have made minor structural changes that reflect the growth of the Citygate market, including revising the CPIM to include a Citygate index to calculate the alternate benchmark.

¹¹ Appendix A, PG&E's Gas Accord II – 2004 Prepared Testimony, January 13, 2003.

¹² PG&E is already utilizing NGX in some of its Canadian gas transactions.

¹³ Citygate gas supplies are generally priced higher than California border supplies, enabling sellers to recover a larger percentage of capacity costs.

Protests

Anyone wishing to protest this filing may do so by sending a letter by **February 18, 2003**, which is 21 days from the date of this filing. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. Protests should be mailed to:

IMC Branch Chief – Energy Division
California Public Utilities Commission
505 Van Ness Avenue, 4th Floor
San Francisco, California 94102

Facsimile: (415) 703-2200
E-mail: jjr@cpuc.ca.gov

Protests also should be sent by e-mail and facsimile to Mr. Jerry Royer, Energy Division, as shown above, and by U.S. mail to Mr. Royer at the above address.

The protest should be sent via both e-mail and facsimile to PG&E on the same date it is mailed or delivered to the Commission at the address shown below.

Pacific Gas and Electric Company
Attention: Les Guliasi
Director, Regulatory Relations
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, California 94177

Facsimile: (415) 973-7226
E-mail: RxDd@pge.com

Effective Date

PG&E requests that this filing be approved upon regular notice, **March 9, 2003**, which is 40 days after the date of this filing. PG&E will implement this filing on the first day of the month following the month in which the Commission approves this filing.

Notice

In accordance with General Order 96-A, Section III, Paragraph G, a copy of this advice letter is being sent electronically and via U.S. mail to parties shown on the attached list, and the parties on the service list for Gas Accord A. 01-10-011. Address changes should be directed to Sandra Ciach at (415) 973-7275. Advice letter filings can also be accessed electronically at:

http://www.pge.com/customer_services/business/tariffs/

Vice President - Regulatory Relations

Attachment

cc: Gas Accord Service List A. 01-10-011