STATE OF CALIFORNIA

ARNOLD SCHWARZENEGGER, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

April 14, 2007

Advice Letter 2801-G

Rose de la Torre
Pacific Gas & Electric
77 Beale Street, Room 1088
Mail Code B10C
San Francisco, CA 94105

Subject: Pre-Approval of Incremental Storage Contracts

Dear Ms. de la Torre:

Advice Letter 2801-G is effective February 22, 2007. A copy of the advice letter and resolution are returned herewith for your records.

Sincerely,

Sean H. Gallagher, Director
Energy Division

REGULATORY RELATIONS
Tariffs Section
M Brown
R Dela Torre
B Lam
D Poster
M Hughes

APR 18 2007

Return to ______ Records File ______

cc. to ______

Pacific Gas and Electric Company®

Brian K. Cherry
Vice President
Regulatory Relations

77 Beale Street, Room 1087
San Francisco, CA 94105

Mailing Address
Mail Code B10C
Pacific Gas and Electric Company
P.O. Box 770000
San Francisco, CA 94177

415.973.4977
Internal: 223.4977
Fax: 415.973.7226
Internet: BKC7@pge.com

January 24, 2007

Advice 2801-G
(Pacific Gas and Electric Company ID U 39 G)

Public Utilities Commission of the State of California

Subject: Pre-Approval of Incremental Storage Contracts

Pacific Gas and Electric Company (PG&E) submits this advice letter to request California Public Utilities Commission (Commission) pre-approval to execute two incremental gas storage contracts which will enhance core portfolio reliability during peak demand events. This advice letter is submitted in compliance with the procedures set forth in Decision (D.) 06-07-010.

Purpose

Decision 06-07-010 adopted PG&E's proposal for a 1-day-in-10-year peak-day planning standard for its core customers and authorized PG&E to acquire additional storage capacity through a solicitation for offers. In addition, the Commission established approval procedures for any contracts resulting from the solicitation. The approval procedures require consultation between PG&E, the Division of Ratepayer Advocates (DRA), and The Utility Reform Network (TURN). If PG&E, DRA and TURN all support approval, incremental storage contracts may be submitted to the Energy Division by letter request and by advice letter if the three parties are not all in agreement (see D.04-09-022, at mimeo pages 27-28, as modified by D.06-10-035).

In accordance with the procedures established in D.06-07-010, PG&E issued a request for offers for incremental core storage on December 15, 2006. On January 11, 2007, PG&E received four offers from two bidders. PG&E, DRA and TURN reviewed the offers, and PG&E and DRA recommend acceptance of two. TURN stated its belief that meeting PG&E's peak-day planning standard through the acquisition of additional peaking contracts would be a lower-cost alternative, and does not recommend acceptance of any of the four storage offers. Consequently, PG&E requests approval of the two offers through the normal advice letter process.

Description of Evaluation Criteria

As directed by the Commission in D.06-07-010, PG&E issued a Request For Offers (RFO), soliciting offers for incremental gas storage services for PG&E's core customers. PG&E received four offers from two storage providers and evaluated each offer based on the following criteria, established by the Commission's order:

Whether or not the offer(s) help to meet the core planning standard;
Whether or not the offer(s) provided economic benefits to core customers;
Whether or not the offer(s) reflected reasonable market prices;
Operational flexibility and benefits provided; and
Relative economic benefits among the offers.

All offers met the first criterion. Each contract would increase core portfolio reliability and assist PG&E in attaining the adopted 1-day-in-10-year peak-day planning standard. All offers also met the second criterion in that they would reduce reliance on diversions of noncore gas and the resulting significant diversion penalties the core would have to pay in the event of such a diversion. In addition, in the event of a peak-day event, each offer would reduce the core's exposure to the spot gas market when spot prices would be expected to increase significantly.

Regarding the third criterion, the recommended offers are less than the market price range anticipated by PG&E and the Commission in D.06-07-010, at <u>mimeo</u> page 2. There, the Commission noted its anticipation that the average residential customer's monthly bill would increase about 8 to 40 cents, depending on the cost of the final incremental storage inventory that is acquired. The reservation charges for the two selected offers, plus injection and withdrawal charges, will actually result in an increase in the average (45 decatherms per month) residential customer's bill of 2 cents per month, less than a 0.1 percent increase. The net benefit to core customers will be enhanced by the benefit of having one Bcf of gas purchased at summer gas prices, which will be used to reduce purchases of an equivalent amount of gas at winter prices. (This value is currently estimated at $1,000,000 per year.) Although the unit costs of the recommended offers are higher than the cost of PG&E's traditional core storage services, the unit costs are in line with market prices for storage peaking services, especially considering the value of the avoided costs of spot market gas and any diversion penalties during a peak event.

In terms of the fourth and fifth criteria, the offers differed in their operational flexibility and economic benefits. Operational flexibility, provided mainly by injection optionality and daily maximum withdrawal rights, are important features which will enable PG&E to effectively manage the proposed incremental storage assets. In this regard, the recommended offers exhibit considerable flexibility. In tandem, these offers provide flexibility and value for core customers.

PG&E evaluated the relative economics of the offers using intrinsic and rolling-intrinsic value methodologies. Intrinsic value reflects the expected arbitrage value, based on forward purchase prices of the gas to be injected compared to expected prices of the gas during the withdrawal period. Specifically, intrinsic value is derived by calculating the difference between projected gas costs during the injection period and the expected cost of an equal quantity of flowing supplies which would otherwise be purchased during the withdrawal period.

The rolling-intrinsic value methodology starts by calculating the intrinsic value. Then the process simulates potential market outcomes through time, and reevaluates the arbitrage value of storage transactions as the simulated gas market prices change. For each simulated price path, the model determines if arbitrage value greater than initial intrinsic value can be realized. The rolling intrinsic value is expected value (average) of the simulated arbitrage values and is by definition greater than the initial intrinsic value. PG&E used the Financial Engineering Associates (FEA) storage evaluation model, which is commonly used within the gas industry, to calculate the rolling-intrinsic value of each of the offers.

The intrinsic value sets a lower bound on the market value of the storage product and the rolling-intrinsic value can be viewed as an upper bound on the market value of the storage product. The prices offered to PG&E for the storage products recommended for approval fell within the range set by the calculated intrinsic and rolling-intrinsic values. Consequently, the costs that were bid are consistent with levels at which one would expect the market to transact, and therefore meet a reasonable cost test. PG&E shared the model results and discussed other attributes of each offer with DRA and TURN, and also explained the results to Energy Division.

TURN has stated its belief that additional peaking contracts would adequately satisfy the 1-day-in-10-year peak-day planning standard at a lower cost. However, TURN's belief is at odds with the findings and conclusions of D.06-07-010. The 1-day-in-10-year peak-day planning standard adopted by the Commission determines the appropriate level of firm pipeline and storage capacity that PG&E should hold on behalf of its core customers. Ordering Paragraph 1 of D.06-07-010 is clear in ordering PG&E to acquire incremental firm storage capacity to meet the 1-day-in-10-year peak-day planning standard. It was only if PG&E could not acquire the storage capacity at a reasonable cost that PG&E should consider additional pipeline capacity or peaking supply contracts as alternatives.

Peaking contracts are not comparable to firm storage assets and provide less value because from a contractual standpoint, peaking contracts are merely prearranged swing (spot gas) deals that have been enhanced by the addition of non-performance provisions. The buyer (PG&E) pays an upfront demand charge and a premium to the daily swing price in return for the right to call on the gas in a potentially tight and stressed market, as well as the right to impose liquidated damages if a supplier does not deliver gas when requested.

Peaking contracts do not provide the same assurance of firm in-state gas supplies that storage capacity provides. While non-performance provisions in a peaking contract offer a measure of after-the-fact compensation, such provisions do not guarantee the delivery of gas supplies on the days the gas is needed.

PG&E's typical standard peaking arrangements also provide significantly less operational flexibility than storage contracts. Most peaking contracts require the buyer to exercise its right to call on gas between 6:00 AM and 6:30 AM on the day before gas flows. On weekend or holiday periods, the right must be exercised on the last business day before the weekend or holiday, sometimes well in advance of PG&E's gas traders actually knowing the final load forecast for a given day. During the peak winter season, this is significant because there are three multiple-day holiday periods, including the Christmas and New Year's periods when gas trading typically shuts down. On the other hand, a firm storage contract typically provides the ability to nominate withdrawals a day at a time and to adjust withdrawals throughout a gas day to react to changing load conditions. Storage contracts also offer the flexibility to spread withdrawals over more than ten days at a lower withdrawal rate, whereas peaking deals have a finite call right only on a limited number of days.

For these reasons, PG&E's standard peaking arrangements do not provide the same level of reliability or value to core customers as does firm storage capacity. In short, peaking arrangements are not a complete substitute for firm storage capacity but are rather another tool that PG&E uses to be prepared for the possibility of a shortfall in gas supply.

Copies of: (1) the bid submittal sheets describing the term, inventory, injection and withdrawal capacities of all offers; (2) each storage provider's service reliability certification; (3) a one-page evaluation sheet; and (4) each storage provider's acceptance of PG&E's contract and agreement to hold offers open for 30 days, are provided to TURN, DRA and the Energy Division in a confidential addendum to this advice letter.

Adjustment to PG&E's Core Procurement Incentive Mechanism (CPIM)

In order to incorporate the incremental storage into PG&E's CPIM, the benchmark injection schedule will be adjusted by the amount of incremental injections on the day the gas is actually injected. Similarly, the CPIM withdrawal schedule will be adjusted by the amount of withdrawn incremental storage gas on the day that the withdrawal actually takes place.

Summary of Recommended Contracts

PG&E recommends Commission (Energy Division) approval to enter into the following two contracts for terms of two years each, from April 1, 2007 through March 31, 2009.

Table 1
Incremental Core Storage
Proposed Contract Terms

Provider	Inventory (Dth)	Withdrawal (Dth/d)	Contract Cost Estimate
Lodi Gas Storage	500,000	50,000	$2,060,000
PG&E	500,000	50,000	$1,700,000
Total Contracts	1,000,000	100,000	$3,760,000

The two offers meet all the selection criteria and fall within an acceptable range defined by their estimated intrinsic and rolling-intrinsic values. Together, the two contracts will provide 100,000 Dth per day of additional withdrawal capability from December 15 through February 15, enabling PG&E to meet the 1-day-in-10-year peak-day planning standard during this two-year period. In addition, they provide a range of withdrawal rights and injection schedules that will enable PG&E to optimize storage transactions for the benefit of core customers.

PG&E requests that the Commission (Energy Division) approve the proposed storage arrangements by February 22, 2006. After that date, the offerors will have the option to withdraw their offers.

This advice letter will not affect any other rate or charge, cause the withdrawal of service, or conflict with any other rate schedule or rule, although approval of the advice letter will result in the cost of the storage contracts to be included in monthly core procurement rates.

Protests

Anyone wishing to protest this filing may do so by letter sent via U.S. mail, by facsimile or electronically any of which must be received no later than February **13, 2007**, which is twenty **(20) days** from the date of this filing. Protests should be mailed to:

CPUC Energy Division
Tariff Files, Room 4005
DMS Branch
505 Van Ness Avenue
San Francisco, California 94102

Facsimile: (415) 703-2200
E-mail: jnj@cpuc.ca.gov and mas@cpuc.ca.gov

Copies of protests also should be mailed to the attention of the Director, Energy Division, Room 4004, at the address shown above.

The protest also should be sent via U.S. mail (and by facsimile and electronically, if possible) to PG&E at the address shown below on the same date it is mailed or delivered to the Commission:

Brian K. Cherry
Vice President, Regulatory Relations
Pacific Gas and Electric Company
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, California 94177

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

Effective Date

PG&E requests Commission pre-approval of this filing effective **February 22, 2007**, which is 29 days after the date of this filing. After that date, the offerors will have the option to withdraw their offers.

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 A. 05-03-001. Address changes should be directed to Rose de la Torre at (415) 973-4716. Advice letter filings can also be accessed electronically at:

http://www.pge.com/tariffs

Brian K Cherry/mt

Vice President, Regulatory Relations

Confidential Attachments

cc: Sean Gallagher, Director of Energy Division
Richard A. Myers - Energy Division
Eugene Cadenasso - Energy Division
Jonathon Bromson - Legal Division
Mark Pocta - Division of Ratepayer Advocates
Marcel Hawiger - The Utility Reform Network
Service list – A. 05-03-001

CALIFORNIA PUBLIC UTILITIES COMMISSION

ADVICE LETTER FILING SUMMARY
ENERGY UTILITY

MUST BE COMPLETED BY UTILITY (Attach additional pages as needed)

Company name/CPUC Utility No. Pacific Gas and Electric Company U39M

Utility type:	Contact Person: Megan Hughes
☒ ELC ☒ GAS	Phone #: (415) 973-1877
☐ PLC ☐ HEAT ☐ WATER	E-mail: MEHr@pge.com

EXPLANATION OF UTILITY TYPE	(Date Filed/ Received Stamp by CPUC)
ELC = Electric GAS = Gas	
PLC = Pipeline HEAT = Heat WATER = Water	

Advice Letter (AL) #: 2801-G
Subject of AL: Pre-Approval of Incremental Storage Contracts

Keywords (choose from CPUC listing): Storage, Contracts

AL filing type: ☐ Monthly ☐ Quarterly ☐ Annual ☒ One-Time ☐ Other ____________

If AL filed in compliance with a Commission order, indicate relevant Decision/Resolution: D.06-07-010

Does AL replace a withdrawn or rejected AL? If so, identify the prior AL

Summarize differences between the AL and the prior withdrawn or rejected AL[1]:

Resolution Required? ☐ Yes ☒ No

Requested effective date: February 22, 2007 No. of tariff sheets: 0

Estimated system annual revenue effect: (%):

Estimated system average rate effect (%):

When rates are affected by AL, include attachment in AL showing average rate effects on customer classes (residential, small commercial, large C/I, agricultural, lighting).

Tariff schedules affected:

Service affected and changes proposed[1]:

Pending advice letters that revise the same tariff sheets: N/A

Protests and all other correspondence regarding this AL are due no later than 20 days after the date of this filing, unless otherwise authorized by the Commission, and shall be sent to:

CPUC, Energy Division
Attention: Tariff Unit
505 Van Ness Ave.,
San Francisco, CA 94102
jnj@cpuc.ca.gov and mas@cpuc.ca.gov

Utility Info (including e-mail)
Attn: Brian K. Cherry
Vice President, Regulatory Relations
77 Beale Street, Mail Code B10C
P.O. Box 770000
San Francisco, CA 94177
E-mail: PGETariffs@pge.com

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[1] Discuss in AL if more space is needed.

PG&E Gas and Electric Advice Filing List
General Order 96-A, Section III(G)

ABAG Power Pool
Accent Energy
Aglet Consumer Alliance
Agnews Developmental Center
Ahmed, Ali
Alcantar & Kahl
Ancillary Services Coalition
Anderson Donovan & Poole P.C.
Applied Power Technologies
APS Energy Services Co Inc
Arter & Hadden LLP
Avista Corp
Barkovich & Yap, Inc.
BART
Bartle Wells Associates
Blue Ridge Gas
Bohannon Development Co
BP Energy Company
Braun & Associates
C & H Sugar Co.
CA Bldg Industry Association
CA Cotton Ginners & Growers Assoc.
CA League of Food Processors
CA Water Service Group
California Energy Commission
California Farm Bureau Federation
California Gas Acquisition Svcs
California ISO
Calpine
Calpine Corp
Calpine Gilroy Cogen
Cambridge Energy Research Assoc
Cameron McKenna
Cardinal Cogen
Cellnet Data Systems
Chevron Texaco
Chevron USA Production Co.
City of Glendale
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CSC Energy Services
Davis, Wright, Tremaine LLP
Defense Fuel Support Center
Department of the Army
Department of Water & Power City
DGS Natural Gas Services
Douglass & Liddell
Downey, Brand, Seymour & Rohwer
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Duke Energy North America
Duncan, Virgil E.
Dutcher, John
Dynegy Inc.
Ellison Schneider
Energy Law Group LLP
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Exelon Energy Ohio, Inc
Exeter Associates
Foster Farms
Foster, Wheeler, Martinez
Franciscan Mobilehome
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Gas Transmission Northwest Corporation
GLJ Energy Publications
Goodin, MacBride, Squeri, Schlotz &
Hanna & Morton
Heeg, Peggy A.
Hitachi Global Storage Technologies
Hogan Manufacturing, Inc
House, Lon
Imperial Irrigation District
Integrated Utility Consulting Group
International Power Technology
Interstate Gas Services, Inc.
IUCG/Sunshine Design LLC
J. R. Wood, Inc
JTM, Inc
Luce, Forward, Hamilton & Scripps
Manatt, Phelps & Phillips
Marcus, David
Matthew V. Brady & Associates
Maynor, Donald H.
MBMC, Inc.
McKenzie & Assoc
McKenzie & Associates
Meek, Daniel W.
Mirant California, LLC
Modesto Irrigation Dist
Morrison & Foerster
Morse Richard Weisenmiller & Assoc.
Navigant Consulting
New United Motor Mfg, Inc
Norris & Wong Associates
North Coast Solar Resources
Northern California Power Agency
Office of Energy Assessments
OnGrid Solar
Palo Alto Muni Utilities
PG&E National Energy Group
Pinnacle CNG Company
PITCO
Plurimi, Inc.
PPL EnergyPlus, LLC
Praxair, Inc.
Price, Roy
Product Development Dept
R. M. Hairston & Company
R. W. Beck & Associates
Recon Research
Regional Cogeneration Service
RMC Lonestar
Sacramento Municipal Utility District
SCD Energy Solutions
Seattle City Light
Sempra
Sempra Energy
Sequoia Union HS Dist
SESCO
Sierra Pacific Power Company
Silicon Valley Power
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White & Case
WMA