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IMC Branch Chief, Energy Division
California Public Utilities Commission
505 Van Ness Avenue, Room 4002
San Francisco, CA 94102

Re: **Response to Protests from Kern River Gas Transmission Company and Lodi Gas Storage LLC to Advice 2624-G - Expedited Advice Letter Requesting Pre-Approval of El Paso Pipeline Capacity Contracts**

Pacific Gas and Electric Company (PG&E) responds to protests dated April 28, 2005, from Kern River Gas Transmission Company (Kern River) and Lodi Gas Storage, LLC (Lodi) to PG&E's Advice 2624-G dated April 18, 2005, regarding pre-approval of three proposed restructured transportation service agreements (TSAs) between PG&E and El Paso Natural Gas Company (El Paso).

Discussion of Kern River Issues

Kern River asserts that the most appropriate method to test alternatives is to conduct a competitive bidding process. Kern River also states that PG&E negotiated with a single pipeline, El Paso. For these reasons, Kern River requests that the Commission reject PG&E's restructured TSAs. However, Kern River's assertions are not based on facts.

The Commission's Capacity OIR Decision (D.) 04-09-022, does not require utilities to utilize a competitive bidding process when acquiring pipeline capacity. Instead, the decision specifies "negotiation" as a method by which utilities may acquire capacity for Commission approval, by expedited or existing approval request procedures. Specifically, the Commission grants authority to the utilities to negotiate capacity contracts on behalf of their gas customers.[1]

Second, PG&E employed a rigorous evaluation process to identify the best alternative, and shared its evaluation with ORA, TURN and the Energy Division prior to concluding its arrangement with El Paso, in compliance with D. 04-09-022.

[1] Finding of Fact 3, Conclusions of Law 1, and Ordering Paragraph 1 specify "negotiate," when referring to utility authority to acquire pipeline capacity.

PG&E obtained market information from various sources and evaluated viable alternatives. Prior to finalizing its proposal to El Paso, PG&E analyzed information contained in Kern River's recent open season, and verified economic assumptions to determine that San Juan supplies delivered by El Paso provided superior benefits to PG&E's gas customers. PG&E also discussed the open season with Kern River and found the terms contained in the open season process would bind core customers to Kern River for a minimum of 10 years at rates considerably higher than the current market conditions would support.

PG&E analyzed offers from a competing pipeline and discussed capacity releases with other shippers. In fact, PG&E contacted Kern River shippers, including merchant power generators, as suggested by Kern River. These discussions with Kern River shippers did not yield alternatives that were superior to PG&E's proposed El Paso TSAs, as implied by Kern River.

Kern River suggests that a bid process is the best mechanism for testing competitive alternatives. However, a competitive bid process would have only applied to the potential replacement of PG&E's expiring El Paso Contract 9Q7P, with a contract quantity of 97,752 Mcf per day, and would not have applied to the other two TSAs with future termination dates. By renegotiating the three El Paso contracts together as a package, the benefits referred to in Advice 2624-G apply to the entirety of PG&E's proposed El Paso contracts, or 200,000 Mcf per day. These restructured El Paso arrangements recognize market realities and support the needs of Northern California core customers by providing reliability, security and flexibility in a manner superior to other capacity opportunities presented to PG&E.

Kern River also states that Southern California Gas Company (SoCalGas) demonstrated the benefits of supply diversity, and in particular access to Rocky Mountain supplies, in its initial filing in Rulemaking 04-01-025. Kern River claims that having 500 MMcf per day of Rocky Mountain supplies would lower SoCalGas's "market clearing price" by 18 cents per Mcf. As support, Kern River refers to Appendix B, "Diversity values of Enhanced Supply Access."

PG&E reviewed that document, and without critiquing the analysis, the gas costs assumptions which derive the alleged benefits of Rocky Mountain supplies to California gas customers bear no resemblance to today's market conditions. The market prices used in the February 2004 filing show Rocky Mountain commodity prices to be approximately $.50 cheaper than San Juan Basin prices. The current forward price curves from actual price quotes indicate virtual parity between San Juan supplies and Rocky Mountain supplies delivered to California. In fact, SoCalGas acknowledged that the results of its analysis are highly dependent upon the relative market prices for gas. If the current market prices are applied to the same analysis, a very different result is obtained; one which strongly supports PG&E's El Paso arrangements.

Kern River praises the benefits of supply diversity. However, PG&E already enjoys the benefits of enhanced geographic and pipeline diversity by purchasing substantial quantities of Alberta supplies via TransCanada's GTN and Canadian pipelines, in addition to Southwest sourced supplies via El Paso and Transwestern Pipeline Company. Furthermore, both El Paso and Transwestern receive Rocky Mountain supplies directly, delivered through upstream pipelines connected to their San Juan receipt points. In addition, PG&E's service area contains a vibrant and liquid citygate market. This market enjoys the benefits of Rocky Mountain supply deliveries directly into PG&E's service area when those supplies are competitive. PG&E core gas traders routinely conduct transactions at PG&E's citygate and Daggett, the Kern River interconnect with PG&E, which involve supplies sourced in the Rocky Mountains.

In compliance with D 04-09-022, PG&E shared with ORA and TURN its market evaluation, which indicated that San Juan supplies delivered through the proposed El Paso contracts will provide superior benefits in the near term when compared to Rocky Mountain supplies delivered through Kern River. ORA and TURN concurred that PG&E should finalize the arrangements with El Paso.

Kern River did not protest SoCalGas's Advice 3443, dated December 22, 2004, in which SoCalGas requested Commission approval of a precedent agreement for restructured El Paso contracts. Similar to PG&E's Advice 2624-G, SoCalGas proposed to replace expiring El Paso contracts with new El Paso contracts totaling approximately 775 Mcf/d under pricing and terms similar to the restructured contracts proposed by PG&E. Furthermore, Advice 3443 does not indicate that SoCalGas employed a competitive bidding process as described by Kern River. Thus, there are no discernable significant differences between the methods employed by PG&E and SoCalGas (for four times the volume), or the results.

Discussion of Lodi Gas Storage Issues

Lodi faults PG&E for not explicitly evaluating the trade-offs between interstate pipeline capacity and gas storage capacity. Lodi specifically suggests that because no information concerning the amount of expected unused capacity was provided, the Commission is not in a position to determine whether the proposed interstate pipeline capacity is in the customers' interest. Lodi's criticism has no bearing on the situation at hand.

Less than a year ago, D. 04-09-022 established a minimum level of interstate capacity that PG&E is obligated to hold for core customers. PG&E's current capacity holdings match the mandated minimum; the contract negotiated between PG&E and El Paso is simply designed to renew a contract due to expire at the end of April 2005 and to restructure the remaining El Paso contracts, at very attractive terms for core customers. The proposed El Paso contract does not change in any way the current aggregate level of interstate capacity held for the core. A reduction in the level of interstate capacity held for core would be in direct contravention of the Commission's current policy.

The arguments put forward by Lodi in their protest are hardly new. In fact, Lodi made the same arguments, in much greater detail, in their comments filed in Phase I of the California Gas Capacity OIR—the very proceeding in which the Commission established the minimum interstate pipeline capacity threshold. Lodi is simply reiterating an issue which has recently been resolved by the Commission.

The issues raised by Kern River and Lodi are inconsistent with the Commission's recently stated policy objectives, and should be rejected. PG&E respectfully requests that the Commission approve Advice 2624-G as filed.

Sincerely,

Brian K. Cherry /sr

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