MEMORANDUM

ASSOCIATION OF BAY AREA GOVERNMENTS

Representing City and County Governments of the San Francisco Bay Area

Agenda Item 5C

*12

DATE: **December 6, 2012**

TO: ABAG POWER Executive Committee

FROM: Gerald L. Lahr, Manager, ABAG POWER

RE: **Natural Gas Pipeline Capacity Costs**

Summary. California's "core aggregation" program provides retail choice in the core natural gas market by allowing core customers to purchase gas directly from competitive suppliers (Core Transportation Agents or CTAs) rather than from investor owned utilities (IOUs) such as PG&E. Since the institution of the core aggregation program, CTAs have steadily gained a customer base throughout PG&E's service territory. In fact, CTAs have gained market share now approaching fifteen percent of PG&E's core market. Pursuant to recent California Public Utilities Commission (Commission) decisions, CTAs must take or pay for a share of all long-term interstate pipeline capacity held for core customers by PG&E under contracts that the Commission has approved. Such a requirement jeopardizes CTAs' abilities to compete with PG&E, thereby decreasing value for core customers.

Background. Under previous Commission rulings related to PG&E's natural gas transportation and storage issues (commonly referred to as the 'Gas Accord'),[1] CTAs have benefitted from the right to request and receive an assignment of PG&E's core interstate pipeline capacity in monthly or annual increments, but have never been obligated to pay for pipeline capacity contracted by PG&E for its core customers that the CTAs did not actually use. In the Gas Accord II (2002) decision, however, the Commission required that, once the January capacity factor for all CTAs reached 10% of PG&E's total January core loads, CTAs would be required to pay for a percentage of PG&E's excess pipeline and storage capacity in an amount equal to their market share whether or not CTAs use the capacity. Under this policy, CTAs would have been required to pay for their entire pro rata share of core capacity beginning April 2012 because the January capacity factor for CTAs exceeded 10% prior to April 2011.

The most recent Gas Accord V Settlement (2011), however, modified the implementation of the "full cost responsibility" policy adopted in Gas Accord II. Under the CTA Settlement PG&E and a number of CTAs (including ABAG POWER) agreed to a three-year process, beginning in April 2012, for a phase-in of the full cost sharing, which the Commission approved. Under this modified arrangement, after April 2015, each CTA will be required to pay for (but not necessarily hold) their entire pro rata share of PG&E's core interstate pipeline capacity. A CTA can continue to take an assignment of PG&E's capacity, and its payment for the use of the assigned capacity contributes to its obligation for the costs of PG&E's capacity.

Additionally, as part of the Gas Accord V settlement, PG&E is required to release any capacity that is not accepted by CTAs to the marketplace through an auction, and any revenue from this process will be used to offset the cost responsibility of the CTAs ('unrecovered capacity costs').

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[1] The original Gas Accord was adopted in 1997 and implemented during the period 1998-2002. Subsequent Gas Accord agreements have generally followed every 2-3 years.

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In July 2011 ABAG POWER joined with other CTAs ('CTA Consortium') in an effort to further reduce its exposure to the stranded capacity costs created by PG&E. The Consortium hired legal counsel (Winston & Strawn) and a technical consultant (Crossborder Energy) to study the issues and offer advice. Ultimately a decision was made to file a 'Petition to Modify' two prior California Public Utility Commission (CPUC) decisions. A petition was initially filed on May 17, 2012,[2] as follows:

- Modify Decision 03-12-061 to allow CTAs to opt out of an allocation of PG&E's interstate pipeline capacity holdings when the underlying contracts come up for renewal in order to minimize their exposure to stranded costs.
- Replace the requirement set forth in Decision 04-09-022 that PG&E must hold between 962 and 1,058 MMcf/d of interstate pipeline capacity for core customers with a requirement that PG&E must hold interstate capacity in an amount equal to between 100% and 120% of its forecast daily bundled core demand.

In its filing the Consortium explained that these modifications were being requested in order to:

- Enhance gas supply choice for PG&E's core gas customers
- Reflect the significant reduction in bundled core demand on the PG&E system, compared to growth in pipeline capacity serving California.
- Align the core capacity requirement for PG&E with the core capacity requirement of Southern California Gas Company and San Diego Gas & Electric.
- Automatically accommodate changes in the level of PG&E's bundled core portfolio demand.
- Reduce pipeline capacity costs for all of PG&E's core gas customers.

In September, PG&E filed an Advice Letter with the CPUC seeking to approve a one-year extension of two existing pipeline contracts. The Consortium (in collaboration with Shell) filed a response to the Advice Letter calling the Commission's attention to the fact that PG&E's request to extend these contracts perpetuates a pipeline capacity cost burden on CTAs and their customers, and reminding them of the previously filed Petition to Modify. The CPUC subsequently approved PG&E's Advice Letter, although they acknowledge the issues raised by CTAC.

In November, the CPUC issued a Proposed Decision (PD) for each of the two Petitions filed by CTAC. One of these PDs offers a modest amount of relief by lowering the amount of capacity that PG&E is required to hold on behalf of core customers, while the other PD offers little relief, and seems to misunderstand the request stated in the Petitions.

CTAC is now in the process of filing comments on the PDs, as well as meeting with advisors to the CPUC commissioners to clarify, the relief requested in the petitions.

To date, ABAG POWER has obligated itself to spending $11,500 for its share of the legal costs associated with this effort.

[2] At the time of the initial CPUC filing the membership of the CTA Consortium included: Accent Energy, ABAG POWER, Commercial Energy, School Project for Rate Reduction (SPURR), Tiger Natural Gas and UET/Blue Spruce. Shell Energy North America joined the CTA Consortium as a joint petitioner.

Discussion. Earlier this year ABAG POWER began receiving invoices from PG&E for the unrecovered pipeline capacity costs for periods beginning with April in accordance with the Gas Accord V settlement. For the first three months these invoices remained fairly steady at approximately $650/month. However, in July the monthly invoice amount increased to approximately $3,400 and has continued at this level. ABAG POWER staff estimate that the potential total cost burden on the program could theoretically be as high as $44,000/month in 2015 ($528,000/yr), assuming that the CPUC regulations remain unchanged, and PG&E collects zero revenue from its capacity auction. This cost could overwhelm any potential program savings.

In the past, ABAG POWER has chosen not to utilize the interstate capacity offered to it for a variety of reasons, including: (1) the cost of the capacity is relatively high; (2) the amount of capacity offered varies from pipeline to pipeline creating mismatches that lead to stranded capacity; (3) significant administrative burden in implementing and maintaining contracts with the various pipeline companies; (4) accepting the capacity forces the program to purchase gas based on PG&E's selection of pipelines, thus limiting the program's flexibility to purchase gas at the least cost; (5) the relatively small amounts of capacity offered to ABAG POWER are not in quantities that are preferred by gas suppliers.

While ABAG POWER could seek to make more full utilization of the capacity offerings, due to the reasons stated above, to date we have concluded that it is more favorable to decline the interstate capacity offerings; allow the rejected capacity to be entered into PG&E's market auction, and accept whatever revenue is gained as an offset to the cost.

Conclusion. While the goals of ABAG POWER are not solely related to cost savings, this remains a significant driver of the program, and the unrecovered capacity costs could provide a significant barrier to this objective.

In addition, CTAs as a group desire to maintain their ability to choose for themselves the most economical way to supply the natural gas needs of their customers, rather than being bound by the capacity decisions made by PG&E. ABAG POWER concurs with this desire, and therefore intends to continue to support the efforts of the CTA Consortium. It is hoped that the Petition to Modify will gain traction with the CPUC in the near future, so the program can begin to reduce the expense associated with the unrecovered pipeline capacity costs, as the pipeline capacity contracts come up for renewal.

ABAG POWER staff, in collaboration with the Executive Committee will continue to monitor the regulatory proceedings as well as the costs associated with this issue to see if any change in strategy or program operation is warranted.

/vm

CITY OF MILPITAS

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President Michael R. Peevey and Commissioners
Public Utilities Commission of the State of California
505 Van Ness Avenue
San Francisco, CA 94102

Re: ABAG Power Program
PG&E's Pipeline Capacity Charges

Dear President Peevey and Commissioners:

The City is a member of ABAG POWER, a joint power agency which serves as a core transport agent for 38 public entities since 1996. The City has a constituency of over 67,000 California residents. We provide to our citizenry essential services that include: affordable housing, police services, fire protection, community services for youth and the elderly, sanitation and flood control, and public works, we rely on a cost effective and stable supply of natural gas in providing these essential services.

Beginning early last year, CPUC regulations were put into place that require ABAG POWER to take and pay for a portion of PG&E's pipeline capacity. This is a significant burden on the ABAG POWER program and the City for the following reasons:

- ABAG POWER's purchasing strategy does not generally include the tactic of contracting for pipeline capacity separate from the purchase of natural gas.
- Even if ABAG POWER changed its gas purchasing strategy to purchase natural gas and pipeline capacity separately, absent the recent regulations, it would not necessarily match the locations and the amounts that it will be required to take from PG&E.
- ABAG POWER cannot recover its costs by reselling this pipeline capacity.

PG&E claims that this pipeline capacity serves as a hedge against possible future shortages that would prevent it from moving natural gas into the region. There is absolutely no evidence of a shortage of pipeline capacity: in fact, there is significant excess capacity. More importantly, if there were signs of a possible future shortage, ABAG POWER would seek to acquire pipeline capacity that matches its natural gas purchasing strategy – not PG&E's.

The City requests that the CPUC rescind the regulations that require core transportation agents like ABAG POWER to take and pay for PG&E's excess pipeline capacity.

Please contact the City's Purchasing Agent, Chris Schroeder (cschroeder@ci.milpitas.ca.gov , 408-687-1639 or ABAG POWER Manager, Jerry Lahr (JerryL@abag.ca.gov, 510-464-7908) if you have any questions on this issue.

Respectfully Submitted,

Jose S. Esteves, Mayor