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PACIFIC GAS AND ELECTRIC COMPANY
INCREMENTAL CORE STORAGE APPLICATION 05-03-001
PARTIAL SETTLEMENT

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A. Introduction

This document describes a Request for Offer (RFO) process whereby Pacific Gas and Electric Company (PG&E) will seek offers for storage capacity, consistent with a 1-peak-day-in-10 year planning standard. The following sections describe a proposed process that details the product offerings PG&E will be soliciting from the storage market, a list of requirements that must be met by participating storage providers, and a description of the offer acceptance process that PG&E, the Division of Ratepayer Advocates (DRA) and The Utility Reform Network (TURN) would follow.

All parties agree on the Request for Offer (RFO) process, the Core Procurement Group Allocation, and the Operations issues as described in this document. Except for TURN, the parties agree that an appropriate planning objective is for core customers to hold capacity sufficient to meet the 1-day-in-10-year peak day standard, if the capacity can be acquired at a reasonable market price. Except for TURN, the parties agree that the cost of the incremental storage should be borne by bundled core ratepayers.

The parties have not agreed on whether PG&E's credit requirements should apply to independent storage providers, or, if credit requirements are to be applied, what those credit requirements should be.

TURN has not agreed that PG&E needs incremental storage at this time, that PG&E's 1-peak-day-in-10-years cold weather planning standard should be adopted or, if incremental storage is required, that bundled core customers should pay for the full cost of the storage.

Hearings were held on the credit issues and those raised by TURN.

B. Request for Offer (RFO)

If the Commission authorizes PG&E's proposed 1-peak-day-in-10 year planning standard or some other objective that requires incremental storage, PG&E will solicit the market for incremental storage via an RFO, which will be issued no later than November 30, 2006. If the Commission does not authorize PG&E's proposed standard, PG&E,

after consultation with DRA and TURN, will determine whether incremental storage is needed, and will issue an RFO to acquire any needed storage.

1. Products

The RFO will identify the total capacity solicited. Storage providers will be given latitude in deciding what products to offer in response to the RFO and any products they wish to have PG&E, DRA and TURN to consider for economic storage.

The minimum requirements will be as follows:

- Offers are for a two-year term beginning April 2007;
- A minimum inventory of 1 MMDth and a maximum of 10 MMDth for the total storage requirement;
- The withdrawal rate must be a multiple of 50 MDth per day. The minimum acceptable offer is 50 MDth per day of withdrawal for 10 days between

  December 15 through February 15 and sufficient injection to fill the offered inventory by October 31;
- Offers will specify rates for each storage sub-function. Attachment 1 contains a blank offer sheet that storage providers will use to submit their offers; and
- Storage providers will be allowed to submit offers on up to three distinct products. All offers must comply with the minimum requirements described above.

2. Offer Rules and Requirements

- If PG&E's California Gas Transmission (CGT) division chooses to participate in the RFO process, PG&E will provide each independent storage provider (ISP) an officer's certificate indicating that CGT's Products and Services group does not have, and will not have access to information or data detailing the factors and variables which will be utilized by PG&E's Gas Procurement Department (in conjunction with DRA and TURN) in evaluating the received offers.

3. Offer Evaluation Methodology

Before determining the methodology to be used to evaluate offers, PG&E will host a one-day workshop for interested parties that includes DRA and TURN in which

any interested party can propose, explain, and debate methodologies and/or criteria for evaluating offers. PG&E, DRA, and TURN will use the input of the third parties to develop general principles to be used in the evaluation, which PG&E will document and distribute to all parties. Subsequently, PG&E will finalize the evaluation methodology with the direct participation of DRA and TURN in accordance with the principles developed by PG&E, DRA and TURN, and PG&E's business needs. The specific details of the final evaluation methodology will not be distributed to parties. Winning offers will be determined jointly by PG&E, DRA and TURN, consistent with the framework laid out by the California Public Utilities Commission (Commission) in Decision 04-09-022.

A consistent methodology will be employed to develop estimates of the real option value associated with each offered product, taking into consideration operational and reliability constraints inherent in the core gas procurement function. The estimated values, net of costs, will serve as the ranking metric. The forward prices, implied volatilities and correlations which serve as inputs to the analysis will be calculated at the time of evaluation. Carrying costs associated with the offered products will also factor into the analysis.

Upon request, participants whose offers are not accepted may request a meeting with PG&E to discuss the rationale for the rejection of their offers. Based on the evaluation criteria discussed in the pre-bid workshop, PG&E will provide feedback to the participant outlining the areas of the bid proposal where they were not competitive with the winning bid. PG&E will not, however, disclose specific details of the winning bids to other participants.

4. Offer Acceptance Process

- PG&E, DRA and TURN will have 7 business days to evaluate the offers. During that 7-day period, participants in the RFO will be afforded the opportunity to present and explain their offers to the evaluation team.
- Once submitted, offers can not be refreshed. In order to facilitate expedient response time by participants, PG&E will begin informing participants at 9 a.m. Pacific time of the designated day of notification (to be specified in the RFO document) as to the status of their offer(s). Offers can be accepted outright, provisionally accepted, or rejected by PG&E. If a participant's offer(s) is (are)

accepted outright, the participant will have one (1) hour from the time PG&E notifies the storage provider of the provisionally-accepted offer, either to formally commit to or withdraw the offer via fax or e-mail. If the participant's offer is provisionally accepted, the participant will have one (1) hour either to formally commit to or withdraw the offer via fax or e-mail; however, PG&E will have up until 5 p.m. Pacific time, to confirm final acceptance of the offer. The provisional acceptance process will allow PG&E to know which offers remain in the running (not withdrawn) and give PG&E sufficient time to evaluate the relative merit of combinations of offers.

- Once a participant has committed to its offer, the offer is binding and must remain open for 15 days. PG&E will only execute a contract if and when the contract has been approved by the Commission. Storage contracts resulting from the RFO will be presented to the Commission for approval pursuant to the pre-approval process for pipeline capacity set out in Decision 04-09-022. In this instance, after concurrence from DRA, TURN and PG&E and review by the Energy Division Staff, contract approval would be granted via letter issued by the Director of the Energy Division.
- If, after the 15-day period, the Commission has not formally approved the contract, the participant will have the right to withdraw its offer.

5. Additional Considerations

- Consistent with the PG&E-DRA Agreement (Attachment 1 to Ch. 1 of PG&E's Prepared Testimony), if no offers or no combination of prorated offers meets a reasonable price threshold, PG&E reserves the right, in consultation with DRA and TURN, to reject all offers. Under such circumstances, PG&E may do one of the following:

  (1) Issue a new RFO within a reasonable time-frame after the initial RFO; or
  (2) Open direct negotiations with the storage providers to fashion an acceptable storage contract. PG&E will submit any negotiated contract for Commission approval following the process described in Decision 04-09-022.

- If an incremental storage contract is awarded to CGT, PG&E agrees that the capacity associated with the incremental contract will not be subsumed into the

base core storage allocation. Prior to the expiration of the initial incremental storage contract(s), if it is determined that PG&E's core customers should continue to hold incremental storage capacity, PG&E will solicit the market for new storage offerings via a competitive and open process.

C. Other Issues

1. Rate Recovery

Incremental storage costs will be included in rates following the same methodology used for the recovery of PG&E's existing core customer storage holdings.

2. Core Procurement Group Allocation

Until such time that Core Transport Agents' (CTA) load reaches the 10 percent level of the January capacity factor, CTAs' pro-rata share of the core customer storage holdings remains at the current level. Specifically, until their load reaches the 10 percent level: 1) CTAs will not be offered a pro-rata share of any incremental storage capacity held by PG&E on behalf of core customers; and 2) CTAs or their customers will not be required to pay for such incremental storage capacity.

If CTA load approaches the 10 percent level of the January capacity factor, PG&E will make a timely proposal for an appropriate treatment of the incremental capacity vis-à-vis CTAs.

3. Operations Issues

Providing storage services to PG&E's core customers will not alter an ISP's obligations or responsibilities under existing Operational Balancing or Interconnect agreements.

All providers of gas storage services to PG&E's core customers are required to maintain storage facilities and equipment that are sufficiently reliable and redundant to ensure contracted volumes of gas can be physically delivered to or received from the PG&E system under a wide range of weather and other adverse environmental conditions. At a minimum, a storage provider proposing to serve PG&E's core customers' incremental reliability storage needs shall provide written certification by an officer of that company that it currently has or will have installed:

1. Standby power generation capacity that assures full contracted volumes can be withdrawn during electric power supply outages;
2. Sufficient available compressor horsepower to assure that contracted volumes can be injected or withdrawn at the prevailing pressures of the interconnecting PG&E pipeline, at set forth in the Operating and Balancing Agreement with the ISP;
3. Operator availability assuring that corrective action is initiated quickly in the event of equipment or power failure;
4. Maintenance practices that provide reasonable assurance that all necessary facilities are available and operable when storage services are needed; and
5. The facilities, equipment, operating procedures, and maintenance practices are consistent with expected gas storage industry practices.

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