

THE CALIFORNIA ENERGY CRISIS AND USE OF THE DEFENSE PRODUCTION ACT

HEARING BEFORE THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

ON

REVIEW OF THE DEFENSE PRODUCTION ACT IN RELATION TO THE
CALIFORNIA ENERGY CRISIS

FEBRUARY 9, 2001

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FRIDAY, FEBRUARY 9, 2001

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Phil Gramm, (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN PHIL GRAMM

Chairman GRAMM. Let me call the Committee to order.

I want to thank our witnesses for coming today. Normally, this early in the session, we do not have hearings on a Friday.

But I wanted to hold this hearing today because this Committee is also the Economics Committee, and we have jurisdiction over the Defense Production Act.

We have an opportunity today—in light of the use of the Defense Production Act in the California energy crisis—to look at this act as we begin the process this year of rewriting the Defense Production Act, rewriting it in an era when Ivan is not at the gate, when the world is very different than it was in 1950—when Harry Truman signed this bill into law and Ivan was very much at the gate and we were beginning a life and death struggle with the Soviet Union.

The Defense Production Act is the most powerful and potentially dangerous American law, in my opinion.

It is a law—whether used correctly or not, I think we can judge that—that was meant to give through legislation an embodiment of the President's powers under Article 2, Section 2 of the Constitution, which names the President, Commander in Chief.

In this extraordinary use of the Defense Production Act, the President delegated authority to the Energy Secretary who, under the authority of the Defense Production Act, forced suppliers to sell to parties that they would not have supplied in the absence of the use of the police power of the Federal Government.

The Federal Government issued an order that a sale be made under conditions which the seller would never have agreed to in the absence of the Federal Government's order. The sale was at a price that the seller would never have accepted under any ordinary circumstances, and where there was no guarantee that the product—in this case, natural gas—would be paid for.

I am not aware that the natural gas has in fact been paid for. And it seems to me that an issue that we have to look at in the

context of the Defense Production Act, if this natural gas should not be paid for—and the Federal Government has ordered that it be supplied under the provisions of the Fifth Amendment’s takings provision—is whether the Federal Government, the Federal taxpayer, is obligated to make these payments?

In addition, I think there is a real question whether or not Section 101(a) and Section 101(c), that were cited by the President and by the Secretary of Energy, actually apply to the circumstances in California.

This is a very important issue. The Defense Production Act was adopted during the Truman Administration, giving the President tremendous economic powers. It was clear in looking at the context of that debate, and the subsequent use of those powers, that Congress intended that those powers be used only in the case of emergencies that had clear national security implications. I deal in looking at the whole history of the Defense Production Act since its inception in 1950, it has been used principally for defense purposes.

There have been two major exceptions, however.

One was Richard Nixon’s use of the Defense Production Act to impose wage and price controls, after which Congress wisely repealed that provision of the law.

The second variance was its recent use in the last few weeks to mandate the sale of natural gas against the business judgment of the private sellers. That is what we are here to look at today.

I want to say publicly to our two distinguished witnesses what I said privately. And that is, I am not here trying to exhume the remains of the Clinton Administration.

What I am trying to do is to understand exactly how this powerful instrument was used, and potentially misused, as we look to rewrite this bill in the 107th Congress. And it is my intention that we have an extensive rewrite of the Defense Production Act. I don’t ever intend to see the act extended again without substantial revision and reexamination.

The world has simply changed too much to allow the Act to be extended in its present form. What we want from our two witnesses, and what I am interested in here, is we take a long, hard, dispassionate look at this decision, how it was implemented, what the implications were, how it was used or misused and what that says to us about rewriting this law.

That is the purpose of this hearing today. I want to thank our two witnesses for coming, and I want to give our two colleagues who have come on Friday, when the Senate is not in session, an opportunity to speak and to thank them for being here.

I am especially grateful to our new colleague from New Jersey. And let me ask Senator Corzine if he wants to make any opening statement.

Senator CORZINE. Well, as I said the other day, I am a newcomer to this and I will wait. But I think that this topic is one very well worthwhile, making sure that we identify the proper application of this law going forward.

And so I think this hearing provides that forum to discover those and I look forward to working with the Chairman.

Thank you.

Chairman GRAMM. Well, thank you. And again, let me thank you for coming.

Senator Enzi.

STATEMENT OF SENATOR MICHAEL B. ENZI

Senator ENZI. Thank you, Mr. Chairman. I am so pleased that you are holding this hearing.

I have a statement that I would like to be in the record. But I have a few comments that I want to make besides that.

Chairman GRAMM. If I can, let me just ask, I do not think anybody else is coming.

Senator Corzine, why don't you come sit here, and when you finish your statement, Senator Enzi, why don't you move up here.

But go ahead.

Senator ENZI. This hearing gives us an opportunity to look at the impact that the Defense Production Act has on the Nation's energy market.

Now, I am from Wyoming, and Wyoming is upstream from California. And with some of the other laws, we kind of feel like there is this giant straw sucking the water out of Wyoming.

This act has the same potential for doing that with the energy of Wyoming.

When California suffers, Wyoming has to panic. It is a very real fear, especially in light of the way that the Defense Production Act places a superior priority on California energy delivery. It scares us up our way.

I talked to my daughter in Laramie this morning. The temperature there is a minus 30 degrees, and they are using some energy right now. They recognize that California needs energy, but we see a pretty desperate need in Wyoming as well.

I cannot help but think that the real issue underlying this crisis is that we have failed to develop a national energy policy.

Somehow, we have placed an idea that we could utilize technology and that would provide conservation, and we would not need additional power.

I cannot understand why we do not think that same ingenuity that produces technology that leads to conservation cannot lead to clean energy as well.

This country is going to have to have some increasing levels of energy if it is going to have the kind of continued growth that provides the jobs that the people in this country have come to rely on, and the kind of increases in the economy that we depend on. So we need to get to that national energy policy. We have to stop focusing on the symptoms and start dealing directly with the disease and the short-term economic band-aids and artificially controlled prices make the situation worse.

Our goals of establishing stability and prices that are truly market-based can only be reached by acting on a plan that allows us to meet our own energy demands.

We have to work within the structure that has some rules with it. So I am grateful that we are holding this hearing and hope that we can save California and Wyoming.

Chairman GRAMM. Great. Let me welcome our two witnesses today—Mr. Eric J. Fygi, who is Acting General Counsel of the De-

partment of Energy, and Paul F. Carrier, who is Director of the Office of Energy Emergencies at the Department of Energy.

First, have I pronounced both your names correctly?

Mr. FYGI. Mr. Chairman, you did a remarkably accurate job, much better than my contracts professor did in law school.

[Laughter.]

Chairman GRAMM. I appreciate that. I always ask people because there is nothing worse than mispronouncing somebody's name.

Let me first say that we are very happy that you are here today. We want to give you an opportunity to present us with this case study of what happened, when and how. And then we want to call on your expertise to pose questions, again, with the goal of understanding what happened and deciding in rewriting this very powerful law, do we want to make changes in it?

Mr. FYGI, why don't you start?

**STATEMENT OF ERIC J. FYGI, ACTING GENERAL COUNSEL
ACCOMPANIED BY PAUL F. CARRIER, DIRECTOR
OFFICE OF ENERGY EMERGENCIES
U.S. DEPARTMENT OF ENERGY**

Mr. FYGI. Mr. Chairman, with the Committee's permission, I would summarize briefly the major elements of our prepared statement and request that the entire prepared statement be included in the record.

Chairman GRAMM. They will be printed in the record as if given.

Mr. FYGI. It is well to understand, in examining this subject in the context of this case of the use of the Defense Production Act, the circumstances in California that gave rise to developing the case itself. And those circumstances, briefly stated, involved the workings of the California electricity rate structure, in light of increased demand experienced by California utilities through the last 5 years in particular, a comparative shortfall in new capacity that was less than a fifth of the increase in demand between 1996 through 1999, a rate cap in which the investor-owned utilities under State law could not charge consumers more than approximately 7 cents a kilowatt, but an evolution of the unregulated wholesale market, such that peak prices in that market were 30 cents, a kilowatt. That put the investor-owned utilities in a position of selling at a loss. It put the investor-owned utilities ultimately in a position where their very financial integrity continued to erode throughout the late fall and early winter of last year.

That was the circumstance that first prompted alarm by the California Independent System Operator and through which all electricity virtually is made available to California consumers, when generators became reluctant to sell to the ISO because of the eroded financial posture of the ultimate purchasing utilities.

That is what prompted the issuance in December of emergency orders under the Federal Power Act to maintain continuity of electric service in California and to avoid, if at all possible, a complete degradation of the continuity of that electric service.

Beginning in January of this year, even though PG&E, the major combined gas and electricity utility in northern California, was not

hamstrung in this rate structure governing its natural gas sales, such that it, PG&E, could recover fully increased costs in the wholesale natural gas that it purchased. Nonetheless, its financial affairs were commingled with its electricity sales. It was a single utility. And the degradation of its financial posture stemming from the electric rate imbalance, coupled with the financial community's adverse reaction to the January 4, 2001, California Public Utilities Commission action on PG&E's emergency rate request, led to a downgrading of PG&E's credit rating by the major credit rating agencies, like Moody's and S&P.

Such that, eventually, PG&E's debt was downgraded to low junk status, according to the Reuter's news account at the time, which was the 16 of January.

By January 12, the senior management of PG&E had come to realize that it was confronted with a serious threat that as much as 40 percent of its gas volumes would be interrupted because the vendors of those gas volumes were made apprehensive by PG&E's deteriorating financial situation, and they were positioning themselves either to terminate their deliveries to PG&E altogether, or to demand financial rearrangements such as prepayments or third-party guarantees, that PG&E's financial posture simply would not permit it to grant.

PG&E's financial posture was such by that time that it could not acquire third-party guarantees, nor, in terms of management of its cashflow, even though, ultimately, it would be compensated through the tariffs from consumer revenues, it simply could not afford either to prepay or guarantee for all the volumes of gas that it needed.

In light of these circumstances, on January 12, the chairman of PG&E formally requested the President to invoke Federal emergency authorities to assure continuity to gas service through the entirety of PG&E's service area. That request was accompanied by a detailed affidavit that set forth in particularity the circumstances PG&E had experienced, which affidavit was sworn and executed by PG&E's chief financial officer.

The next day, Governor Davis formally requested President Clinton to invoke Federal emergency authorities in order to secure continuity of gas service in PG&E's service territory. Governor Davis represented in his letter that his own investigation of the circumstances had persuaded him that the threat was imminent of such an interruption of service.

It was these circumstances that the department was confronted with in early- to mid-January.

As our formal testimony indicates, senior departmental officials from the last Administration, led by the Deputy Secretary, conducted several inquiries directly of PG&E management and operating personnel, better to understand the nature and immediacy of the emergency.

The tenor of those inquiries often was skeptical. It was not one that exhibited an eagerness on the part of the last Administration to become embroiled directly in this further aspect of the whole California matter so soon before it would be ending its term of office. Nonetheless, in the event, the policy judgment was made that the circumstances required action with respect to PG&E's con-

tinuity of gas supply, similar in effect to what previously had been done in December for the electricity supply throughout the State.

As you observed, Mr. Chairman, in your opening remarks, one of the elements of that sort of regulatory approach, and it certainly is a regulatory approach, involves the capacity to mandate sales by vendors to a recipient entity.

The first legal authority that we examined when confronted with the likelihood that some action would be necessary was the Natural Gas Policy Act, which contains several emergency provisions that were patterned after the Emergency Natural Gas Act of 1977. Those emergency provisions, we concluded, were helpful. In fact, they were of key importance. Yet, they did not provide the complete remedy that seemed to be called for—the ability to compel the sale by a vendor to the recipient—here, PG&E. That was the element that was afforded by our resort to the Defense Production Act.

The Defense Production Act, even though relatively infrequently employed in a prominent setting, has been an element of the inventory of energy agency authorities for a very long time—at least back as far as the 1973–1974 Arab oil embargo, in which the Federal Energy Office and the Federal Energy Administration likewise were delegated authorities under the Defense Production Act.

Moreover, the department's predecessor, the Atomic Energy Commission, and, indeed, the department itself in the conduct of our weapons program, had from time to time routinely used the Defense Production Act system of priority orders in the conduct of our national security activities.

Moreover, the Defense Production Act, as it was amended in 1975 by the Energy Policy and Conservation Act, had a new dimension added to it specifically—that is the 101(c) authority—designed to encourage—maximize, I think is the word—domestic energy production. So that contour of the Defense Production Act was relatively familiar to us. And given that in 1980, the Defense Production Act was further amended to have its basic statement of policy expressly indicate that there was a direct link, generically, a direct link between national defense and adequate energy supplies for national defense activities, the structure of the Defense Production Act, when weighed against the facts that we were confronted with, seemed handily to fit.

I say handily to fit because one of the important concerns we had about continuity of natural gas supplies through PG&E's system involved the relationship between those natural gas supplies, that flowing gas, and continuity of electricity generation by independent electrical generators who happen to use PG&E's transportation network in order to feed their electric generators.

I am sure the Committee is aware, most electric generation, and all new thermal fossil-fired electric generation in California, is natural gas-fired.

The reason this was an added concern is that, under California law, if PG&E were confronted with a physical shortfall of available natural gas volumes, such that PG&E could no longer service its so-called core customers under California law—which means private individuals and small businesses, home heating, that sort of thing—then, under PG&E's tariff, it could, and probably would have to, capture volumes of natural gas owned by others, not by

PG&E, but owned by others, that were then flowing through PG&E's pipes to the privately-owned electrical generation facilities.

In PG&E's view, were that event to actually materialize, it would take approximately 2 days before the owners of those volumes of natural gas curtailed shipment through PG&E's system and sold those volumes of natural gas elsewhere, rather than having them conscripted by PG&E under the California regime.

That scenario would have had an additional outage of potentially significant electric generating capacity stemming directly from the degradation of the volumes of natural gas available to PG&E to carry out its normal servicing of its core customers. So there was an interrelationship here.

The need for continuity of natural gas supplies to sustain electric generation in PG&E's service territory directly implicated, in our view, the element of 101(c) of the Defense Production Act, which authorizes resort to orders of priority performance of delivery of goods to maximize energy production.

Moreover, the circumstances that obtained in PG&E's service territory revealed that a number of military and other installations, including NASA installations, are physically situated in PG&E's service territory. Mr. Chairman, as I am sure you are aware, the word defense, as used with respect to Section 101(a) of the Defense Production Act, is a defined term of art in the Defense Production Act, which includes not only atomic energy activities, as well as military activities, but also includes space activities. That is to say, NASA functions.

We also felt that there was an apparent factual basis that rendered application of the Defense Production Act in this circumstance to be correct and appropriate as a matter of law.

I do not want to speak for the policy, but solely for our legal analysis. And therefore, we formulated our legal approach as one that combined the elements both of the Defense Production Act regime and the emergency natural gas authority's regime under the Natural Gas Policy Act.

In fact, President Clinton's Memorandum that made the necessary emergency finding called for by the emergency provisions of the Natural Gas Policy Act, likewise directed the energy secretary also to employ the authorities of the Defense Production Act in order to craft an appropriate regulatory near-term solution to this emergency situation.

Mr. Chairman, I think that this summarizes the prepared statement that we have submitted, which, nonetheless, I hope the Committee will find useful as a resource document as it embarks upon its review of the Defense Production Act.

I think it also is useful to recognize that our case study, so to speak, deals with a profound and discrete emergency prompted by the hitherto unexperienced circumstance where electric utilities were actually suffering from negative operating cashflow. All utility bankruptcies in recent years have involved embedded debt, historical matters. But as a matter of current operations, they were not operating in a negative fashion.

This was truly an extraordinary circumstance prompted by a combination of factors that we alluded to, together with how the

California regulatory structure worked in light of those factors that necessitated resort to these emergency authorities.

And should the Committee have any questions, I will be pleased to respond to them, or, if necessary, seek the assistance from my colleague, Mr. Carrier, in doing so.

Thank you very much.

Chairman GRAMM. Well, Mr. Fygi, thank you very much for a very good summary of what happened and the thinking that was embodied in the use of the laws.

Mr. Carrier, would you like to add anything to what Mr. Fygi has said?

Mr. CARRIER. No, Mr. Chairman. My comments have been included in the testimony filed by Mr. Fygi.

Chairman GRAMM. Well, let me, if I may, first of all, I want to welcome our colleague from Michigan who has joined us.

Let me begin by asking a few questions.

First of all, let me make it clear that I am an economist and not a lawyer.

We did have a rule—in the old days in Texas—that if you were elected to the legislature and served, for a period of time, you could apply and get a law degree.

I sometimes wonder, as long as I have been here, whether I ought to apply and have the Supreme Court declare me a lawyer.

But I do know enough not to get into arguments with the real thing. People generally don't know enough not to get into economic arguments with real economists.

But in any case—

[Laughter.]

What I want to do is understand how the law works, not in some dusty old law book, but in practical application because that is what we are dealing with.

I want to go through Section 101(a) and 101(c) of the Defense Production Act and at least raise questions about applicability, and then I would like to give both of you an opportunity to respond.

First of all, let me go back to the context of 1950 and the Defense Production Act.

For those who have forgotten, in 1950, we were engaged in a very desperate struggle in Korea. The North Koreans had invaded the South. We had been driven back to the Cho San Peninsula. It was very questionable whether we were going to be driven off the peninsula.

We were very much in the midst of a conflict in a country that was war-weary from World War II. And Congress, I think it is fair to say, was frightened. And so, one of the manifestations of our concern and, really, our commitment to engage in this 45-year struggle with the Soviet Union, was the Defense Production Act.

But while Congress meant to give the President tremendous powers—no doubt about that—they also realized that this was a free society and therefore, they wanted to place some real limits. And so, let me begin with Section 101(a), and then pose a few questions to you, if I may.

Section 101(a) authorizes the President to require priority performance of contracts or orders other than contracts of employ-

ment, by any person only if necessary to promote national defense, the person required to perform the contract is capable of doing so.

Throughout, the language of 101(a), obviously, refers to the promotion of national defense. Then it comes down to a section that seeks to set limits. One of the limits is that 101(a)'s authority should be used, "only where necessary or appropriate to promote national defense." It should not be used to accomplish purposes, however meritorious, which bear no relation to national defense.

Now, obviously, one of the things about the military industrial complex is that anything affecting any area of the country almost by definition affects something related to national defense.

But let me ask: Did the Department of Energy ever do any kind of study of what the natural gas that was being ordered to be sold would be used for, where it would be allocated, was any list ever comprised of defense installations that would clearly be affected?

Mr. FYGI. We did receive a list of defense installations, including, as I recall, a NASA facility.

Again, defense is a term of art in the DPA. It is a lot broader than—

Chairman GRAMM. I would count NASA in there.

Mr. FYGI. Yes. So we did receive a list of those facilities that were within PG&E's service area.

Chairman GRAMM. But did that accompany any analysis of where this natural gas would be used?

It seems to me the relevant question is not whether PG&E serviced an area that had defense establishments in it, but were these natural gas supplies that were being ordered to be supplied under conditions the supplier did not agree to, at prices they did not agree to, with no guarantee of payment, was there ever any study as to how that natural gas itself would be used in a way that would supply critical energy to these defenses?

Mr. FYGI. The answer is no because that kind of analysis would only have been called for under the structure of the Defense Production Act, had we resorted to the allocation authority rather than the priority performance of existing contracts or new orders.

Chairman GRAMM. Well, let me raise the following question.

I have here a letter that was sent by PG&E to Governor Gray. And my guess is that this is the letter that really triggered this request that came from the Governor to the President. On page 2 of that letter, in the bottom paragraph, Gordon R. Smith—is he the president of the company?

Mr. FYGI. He is the CEO of PG&E, which is the utility that we are talking about.

Chairman GRAMM. Well, he says in this letter, on page 2, in the bottom paragraph—This is a credit-based shortage, not a physical supply shortage. There are sufficient gas supplies for delivery to California as of today.

If we can believe the president of the company that wrote to the governor, who relayed that request to the President—that there was no shortage of natural gas, but, in fact, a credit-based shortage—I do not find anywhere in Section 101(a) any reference to credit shortages, but, instead, only shortages of material supplies.

Let me first ask, do you agree with the president of the company that credit is the real shortage?

And second, would you say that a credit shortage would qualify under the Defense Production Act?

Mr. FYGI. I would agree with the characterization that the shortage of natural gas through PG&E's system that it confronted was induced by a credit crunch experienced by PG&E.

But in terms of the question whether, nonetheless, the emergency authority of the Natural Gas Policy Act and the authority of the Defense Production Act are available to deal with the shortage, to my mind, it makes no difference whether the shortage gets prompted by a credit crunch or whether it is prompted by a strike or other extrinsic factors such as transportation infrastructure breakdowns and the like.

Chairman GRAMM. Let me read also from Section 101(c)—both these sections were cited in triggering the Defense Production Act.

I think you said, but let me see whether you agree, that the problem found by the President is that one NGPA, the Natural Gas Policy Act, would allow the President to set the terms of a contract, but it did not give the President the power to mandate that the gas be sold or that the pipelines deliver it or that a price be accepted.

Those extraordinary powers, we do not have any dispute about the fact that they came from the Defense Production Act.

Mr. FYGI. Correct.

Chairman GRAMM. Okay. Now, Section 101(c) authorizes the President to require the allocation of or priority performance of contracts or orders related to the supply of materials and equipment in order to maximize domestic energy production.

This authority cannot be used unless the President finds the following. That such supplies are scarce, critical and essential to maintain exploration, production, refining, transportation, or conservation of energy supplies, or the construction and maintenance of energy facilities.

And in going back and looking at legislative history on this, we went back to Senate Report No. 26, which was issued in 1975. And it says the following:

This provision was included in the title in an attempt to remedy critical shortages and misallocations of pipe, pumps, drilling rigs, roof bolts, which are currently plaguing energy production.

I do not see in Section 101(c), at least as the Senate tried to define what it was trying to do in Section 101(c), any reference to natural gas. And I certainly don't see any reference to a credit-based shortage.

Could I get your response to that?

Mr. FYGI. Of course. My first thought is that I am from the Justice Scalia school of thought. I look at the statute. And the legislative history is interesting, but it is not dispositive.

Second, I do not dispute at all the characterization and the likelihood that in 1975, among the things that were of concern to the Senate and, indeed, the whole Congress, involved bottlenecking and shortages of tubular goods.

There was another hearing during which then-Deputy Administrator Sawhill of the Federal Energy Office was testifying on this point, attesting to the need to resolve bottlenecks in the availability of tubular goods and drilling rigs.

Okay?

The answer, it seems to me, is a matter of statutory construction, is that, certainly, the application of this authority to roof bolts or tubular goods is not exclusive. And as a matter of statutory construction, the more likely and plausible and defensible construction, is that the use of the word "materials" in 101(c) is intended to have the same reach of the use of the word "materials" in Section 101(a).

And it is the case that the original legislative history of the 1950 act indicated that in 101(a), the word "materials" included, for example, "petroleum" explicitly.

Petroleum is a lot closer to natural gas than roof bolts. And I think that we would parse the statute in a fashion that corresponds to my description here.

Chairman GRAMM. Let me ask you the following question, and I am not trying to trivialize this or in any way suggest what your decision should have been.

But it seems to me that the danger of stepping over physical shortage, and going back to this credit-based shortage, is that if you take the approach that the inability of a purchaser to pay—even though, as the president of the company said, there was not a physical shortage of natural gas—by that construction, then under this law as it is currently interpreted, in any circumstance where there was no shortage of a product, but a major purchaser of it on a regional basis—in this case, California—the President would have the power under the Defense Production Act with no physical shortage to come in and mandate supply simply because the buyer was not credit-worthy.

I would like to get your reaction to this concern.

Mr. FYGL. I think my reaction to the concern is, first, at risk of using a legal term, this was a *Sui Generis* situation.

Chairman GRAMM. Say again?

Mr. FYGL. *Sui Generis*. This is something truly unique.

We had hitherto never experienced a public utility that could not match its operating expenses from the revenues that it was permitted to charge its rate-payers.

That was something new.

There have been utility bankruptcies before, but they did not involve this kind of problem.

Nonetheless, the nature of the function of the electric utility in the portion of the State that comprises its service territory involves clear public health and safety, as well as national security and national defense preparedness issues of the type that we previously have addressed. And therefore, I think what the department and what both Administrations now have been confronted by is a sobering prospect where the economics of the situation have created a shortage. And where some intervention was necessary to avoid what I think of as a run on the bank.

That is the kind of situation we had here, in my judgment, and it is one that I believe that prompted earnest attention by people at senior levels in both the last Administration and this Administration. I think that we are well on the way to resolving this whole circumstance because the State of California is now grappling with these larger questions that have prompted the difficulties.

And the utility, while still experiencing some difficulty, is able now better to assure creditworthiness because the utility has used the time that was afforded it by this 2-week period of an emergency intervention to secure California Public Utilities Commission approval of something called securitization of its revenue stream for natural gas sales. So that, on an objective standard, for natural gas sales, one probably could conclude that the financial crisis for the natural gas segment should be well under control.

If the question that you are putting to me is, do I think that somehow this particular set of events standing alone is instructive that there is a clear pathway toward potential abuse or extraordinary and unwarranted regulatory action, I think each person has to make his own judgment of that question.

I can say that the facts here do not reveal in my judgment any intention to cross that line.

Chairman GRAMM. I know my colleagues have questions, so let me just pose a couple more questions and then I will yield.

Obviously, there was a real question about the ability of PG&E to pay, which was the reason that the suppliers were unwilling to supply absent the government mandate.

I am not aware that the payment has been made. Do you know?

Mr. FYGI. I can address that. The payment schedule that was mandated by the order was what PG&E had traditionally employed in all of its supply contracts by which it bought natural gas from vendors, which was payment in full on the 25th day of the month for the next prior month's full month of deliveries. PG&E did pay all its vendors on January 25 of this year for all of the deliveries made in December.

December deliveries antedated the effectiveness of the order, but, nonetheless, it seemed to me that the ability of PG&E then to make that payment on schedule was instructive and was a good omen of the likelihood that PG&E similarly will be able to adhere to that payment schedule.

Chairman GRAMM. I am correct in saying, since we hadn't gotten to the 25th, they have not paid for this gas.

Mr. FYGI. Nor have they defaulted.

Chairman GRAMM. Okay. Now, let me ask you the question I wanted to ask.

If they should default, given that the Federal Government mandated that the sale be made, would it be your legal opinion that the Federal Government has a legal liability to pay for this gas?

Mr. FYGI. That is a much more complex question, I have found from such review of it that I have done during this winter.

The Supreme Court case law indicates that each of these inquiries, whether there has been a regulatory taking, is an intently fact-bound one. And so, I do not know that we could discern until after all the facts are in whether even some sort of default would have yielded a compensable regulatory taking or whether it simply would have fallen into the category of regulatory burdens that nonetheless fall short of a compensable taking.

Chairman GRAMM. So you think it would be—it would be your legal opinion if pressed right now, that it would be an open question as to whether the Federal Government and the taxpayer would be liable.

Mr. FYGI. A fact-bound one. But it would be a legitimate issue.

Chairman GRAMM. You all have been very cooperative and I want to thank you because, again, other committees may, through their jurisdiction, want to talk about who screwed this up and who's to blame.

What we are trying to do in rewriting this law, is look at how the law is functioning.

As you know, the President in 1994 set out a procedure for invoking these emergency powers—basically, a system of checks and balances and findings. He then, in essence, waived those procedures using the same executive power.

And what we want to know is, what findings were made that would comply with the original executive order or any requirements of the law?

Mr. FYGI. The thought that occurs to me in responding to that question involves an introductory comment on one way you have characterized the Defense Production Act, as one that is an emergency measure.

In fact, the Department of Justice, in its 1982 comprehensive examination of all emergency authorities available to the President to deal with petroleum emergencies, indicated quite clearly at page 20 of that study that the Defense Production Act really is not an emergency measure. It surely is available in emergencies. But the normal application of the Defense Production Act involves, let's say, a stereotype.

I am the Acme Machine Tool Manufacturing Company and General Dynamics has a contract with the Air Force to build F-16's. My Acme machine tools are in high demand because Detroit is retooling. So General Dynamics issues me an order for my machine tool and I say, sorry, General Dynamics. You are going to have to wait till next year.

Get in the queue.

Well, the normal functioning of the Defense Production Act would entail a procedure within the claiming agency, the Defense Department here, and the Department of Commerce to make a judgment whether to issue an order that would compel Acme to service General Dynamics' request before any other request. And those events occur from time to time in the ordinary business of government and the contracting for materials deemed necessary in the defense effort. They also occur from time to time in major energy projects.

We had used, we found, this authority from 101(c) on several occasions to aid in construction of the Alaska pipeline and on other occasions to aid in securing equipment necessary to upgrade the department's strategic petroleum reserve storage facilities in Louisiana and Texas.

So that, normally, the procedural constraints that tend to mitigate overbroad, perhaps even, arguably, abusive, employment of the Defense Production Act, have this built-in bureaucratic process that you have touched upon.

Here we were, in contrast, dealing with a true emergency where time was of the essence.

And therefore, the President chose a different course in the mode of delegating the Defense Production Act authorities in this case for this purpose at this time.

Chairman GRAMM. Let me yield to my colleagues and I will want to come back and just touch on a couple of things.

Senator Corzine.

Senator CORZINE. Thank you.

Chairman GRAMM. Again, let me thank everybody. There were just some key principles that I felt we needed to get out and that is why I ran over time.

Senator CORZINE. Thank you, Mr. Chairman. I thought the enlightenment of these 101(c) and 101(a) were terrific.

I would like to ask the question in the context of the DPA. It seems like the fact connection to the defense and national security interests are the key element to apply 101(a).

And it was not clear to me from the response to the Chairman's question whether that was more an anecdotal kind of connection that drove the application of this particular act, or whether it was specifics within the context of actual commercial transactions that did not occur.

How did you all arrive at that?

Mr. FYGI. It was neither anecdotal nor retrospective. It was predictive and judgmental because the kind of factual findings we are talking about here in the statute, they are, by necessity, ones that are bound up in policy judgments.

In that sense, they are what we lawyers would call more like legislative facts than adjudicative facts. The case law seems pretty instructive in that the President's factual findings of this sort are entitled to great deference by the courts.

In particular, the Justice Department's 1982 Memorandum cited the Supreme Court's decision in the Algonquin SNG case, under which the President's findings that volumes of imported crude oil were of such an amount and were being imported in such circumstances, as to threaten to impair the national security, was in effect a judgmental one that the President was entitled to make and the courts were not going to set it aside. And similarly, the judgment that in a given instance, the interest of national defense or the interest of maximizing domestic energy production require resort to these authorities is a judgmental one.

Senator CORZINE. Okay. The other question I had is, I am presuming that Secretary Abraham, looking at these same set of facts, drew the same conclusions that Secretary Richardson did.

Mr. FYGI. Secretary Abraham, with two full days of the new job under his belt, instructed me to extend the existing orders.

The factual findings that I think we were speaking about a moment ago were those that were contained in President Clinton's Memorandum, executed on January 19. The duration of President Clinton's memorandum in terms of the yardstick of how long such a declaration of emergency remaining in effect under the natural gas authorities was 120 days.

Clearly, the President Clinton Memorandum still was legally in effect if the new Administration wished to act pursuant to it.

Secretary Abraham did so and instructed me to see to it that the order was extended for the duration that we have described.

Senator CORZINE. Acknowledging the 2 day timeframe, the acknowledgement of the circumstances were generally the same.

Mr. FYGI. Correct.

Senator CORZINE. Though from one judgment to the next.

Mr. FYGI. Correct.

Senator CORZINE. Thank you, Mr. Chairman.

Chairman GRAMM. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

I am actually going to ask three questions and ask them all at the same time, so that if you do not have time within my timeframe to answer them——

Chairman GRAMM. Whatever timeframe you need to get them answered, take it.

Senator ENZI. Thank you, because there are three distinct things that have come to mind partly as I have heard the testimony.

I mentioned in my opening statement that what we are treating are the symptoms and we have to get back to treating the problem.

Symptoms might take care of things in the short-run, but I want to suggest that they are going to escalate things in the short-run.

Most of the natural gas produced in this country is not produced by big companies. It is produced by very small companies, almost individuals that own companies.

They take the revenue that they get from the gas and they pay for the cost of producing it, and at the same time, they begin the production on another well. If something happens in that cashflow, they go out of business, and I think probably the big companies wind up with the gas.

They are not very comforted by the fact that, yes, they probably will be paid, that maybe the February 25 date will be met, or that maybe the Federal Government owes them money. If they are forced to sell the gas and they are then faced with a long, drawn-out battle to get the payment, they do not wind up being in business any more. And that collapses part of the economy in other parts of the country. That is a great concern I have. I am interested in whether there are any plans by the Department of Energy to make sure that these little bitty companies can continue to produce the gas that this country needs, or if we are just turning it over to the large companies?

Mr. FYGI. Well, I think you have raised a very, very good question. And I can assure you that, from my perspective, the last thing in the world we wanted these orders to induce was any longer-term diminution in the supply-side of the equation, including the viability of the small and independent producers that your question particularly was directed to.

Those kinds of issues, I think—that is, the issues embedded in your question—are legitimate and of central importance in framing a larger energy policy because I agree with you in that nothing that was done in what we are testifying about today was a long-term cure for anything. Nor did it masquerade as such.

So I agree with you completely.

Senator ENZI. Thank you. And they are expecting somebody to watch out for them, probably the people that are putting the pressure on it.

Maybe it will only force 10 percent of the people out of the gas business, but if you happen to be that person, it is 100 percent of your business and it is of tremendous concern to them.

The second thing that I am concerned about is getting some more power plants. All of the power plant discussion that I am hearing, particularly from California, is to do natural gas power plants.

I would hope that we are planning some kind of a process where there is clean coal in the country now. That clean coal can be made even cleaner. So there is some possibilities for producing with that.

In Wyoming, we are building power plants to take care of California and other States. I am not sure that Wyoming can do it by itself. But I am concerned about this emphasis on using natural gas for power plants.

I remember a town near us called Rapid City, South Dakota—it is a big city in South Dakota. Their power company was looking at providing peaking power for winter power—a lot more furnaces, fans operating, that sort of thing—to use natural gas to get heat spread through the homes.

They were looking at winter peaking power.

The city did away with their plans to use natural gas because they found that the peaking power—not the total power requirement, just the peaking power requirement—would require as much natural gas as it took to heat Rapid City in winter with natural gas. They did not consider that to be a good use of natural gas.

We are already seeing the price of natural gas in this country go from about \$2.20 to somewhere up around \$8. I suspect if we start putting all of that gas into power plants, next year we will be looking at \$16. I hear some comment that \$16 is an unrealistic price, if everything is going to natural gas, it is going to put a bigger strain on the system than we have now and drive up the prices.

Is that the way you see it with power plants?

Mr. FYGI. Again, I think that the question you have posed should be a central one in a coherent formulation and consideration of national energy policy debates.

I would observe, however, that just earlier this week, the department announced a clean coal cost-sharing project under previously enacted legislative authority, so that the department is quite engaged in pursuit of seemingly promising clean coal initiatives that might yield significantly widespread additional resort to coal as an electric-generating fuel.

So that is the thought that occurs to me from your question.

Whether natural gas or some other fuel should be used for generating electricity, the way you put it, has an implication of a potential regulatory question lurking in the background. I think economists might debate whether a regulatory solution is the best way to decide the highest and best use of natural gas volumes instead of the marketplace.

Senator ENZI. With the potential for the use of this defense act, it is a question the Nation better be looking at because I can see ripples heading across the whole pond that will affect other parts of the country and direct some of the same short-term solutions as we are seeing here.

To bring it back more to the short-term solution, the relationship with this gas and power being needed for national defense.

And again, you can probably put this off on another agency because I know that Defense is going through a process now of doing a readiness evaluation, but it seems to me that it is pretty critical that our defense facilities have some back-up. I was under the impression that they had back-up energy supplies so that defense installations were not put out of business by some kind of national terrorism.

Where the act requires it to be for defense, wouldn't their ability to use their power back-up kind of preclude the action that was taken?

Mr. FYGI. Well, here, again, we are speaking of volumes of natural gas, not electric power, which lends itself more readily to things like diesel generators for use in emergencies and the like.

So that, I am not aware of any defense installations that have ready substitutes for the conventional natural gas service.

Senator ENZI. Okay. It was my understanding that some of that natural gas was going to generate electricity.

Mr. FYGI. That is correct.

Chairman GRAMM. Would the Senator yield?

The issue, it seems to me, is as follows. We claim national defense implications because of the electric service area of PG&E.

We then allocate gas, which may or may not have been used to generate electricity.

It is my understanding that the gas allocations for PG&E, obviously the G being gas in PG&E, are primarily to small users and that the vast majority of defense installations and defense contractors would be buying gas directly and not through PG&E.

Did anybody ever look to see what national defense or NASA installations bought gas from PG&E?

Mr. FYGI. We were provided information on that subject.

Chairman GRAMM. You were or weren't?

Mr. FYGI. We were. I am sorry. Yet, I do not parse the national defense element of the legal equation in quite the same fashion as your question seems to indicate. We considered it sufficient that the presence of these installations in PG&E's gas and electricity service area directly implicated continuity of national defense functions that were dependent on continuity of service by PG&E as a physically viable entity to deliver both gas and electricity.

Chairman GRAMM. Well, I would just like to note for the record that Beall Air Force Base does have back-up power generation. As far as we can determine, they do not buy gas from PG&E, but it is delivered through their pipelines, which would not have been affected.

Mr. FYGI. Actually, they would. Under our scenario, under our high-apprehension scenario, if PG&E had not been able to receive enough volumes of purchased gas to serve its so-called core customers—you know, the residences and the small businesses—then PG&E would have to capture those volumes of gas that were independently being provided through PG&E's system to the Beall Air Force bases and 3M and other manufacturing facilities of the world.

Chairman GRAMM. But—

Mr. FYGI. And that would have disrupted those industrial activities and would also have had the effect of eliminating electric generation capacity that was operating.

So it is all inter-woven to a very significant degree.

Chairman GRAMM. I guess it seems to me that—and we all have a different view of this—if we were concerned about these facilities and their war-making capacity, then we would have simply prevented PG&E from seizing gas that was not PG&E's, but, instead, was simply being transmitted through their pipelines.

Mr. FYGI. I think one can conclude safely that that was not the entirety of the objective.

Senator ENZI. That is all my questions.

Chairman GRAMM. Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman. I appreciate the testimony this morning on a very serious topic.

I know that in Michigan, we are at the early stages of deregulation and watching very closely what is happened in California to learn from the situation.

I also, Mr. Chairman, did want to indicate, noting that coming in just a moment late to the Committee, that the only member that I have more seniority over, Senator Corzine, jumped me in seniority this morning.

I am going to watch him extremely closely at every other meeting to determine how he is using the fact that he has no seniority on this Committee.

[Laughter.]

Senator CORZINE. Why, thank you.

[Laughter.]

Chairman GRAMM. Well, you do have to watch people.

[Laughter.]

Senator STABENOW. I am watching and I am learning, Mr. Chairman very quickly.

[Laughter.]

Chairman GRAMM. I was way down there and I got all the way up here.

[Laughter.]

Senator STABENOW. I noticed that.

Chairman GRAMM. Over dead bodies and——

Senator STABENOW. And I am watching very closely.

[Laughter.]

Which is a topic of another hearing, I think.

[Laughter.]

Let me ask, though, if you might follow up more from the Chairman's questions as it relates to the specifics.

I had similar questions as it relates to contractors that you had talked about and the contractors' installations and how this action would affect their missions and daily activities.

I think this is a very important question as we look at the impact and the actions that were taken. And let me also say that I think it is important to note for us on the Committee that this in fact was an action by both Administrations, the first which Secretary Richardson initiated on January 19, and then followed up by Secretary Abraham, who indicated the circumstances that led to the issuance of the order continued to exist.

We have both administrations appearing to view, at least on the surface, this issue in the same way.

But I do share the Chairman's questions and concerns about the specifics of how this relates to contractors and installations and their ability to carry out their mission and their daily activities.

If you could expand a bit on that.

Mr. FYGI. When you say contractors, I assume you do not mean the contractors who are the vendors of natural gas to PG&E.

Senator STABENOW. I am talking about defense contractors, the installations.

If you could talk about your view of how this would impact their mission, their daily activities.

Mr. FYGI. Well, I think my response would be that, were the situation to have deteriorated as it appeared it might, to the point where PG&E, to keep homes heated, had to siphon off volumes of natural gas to industrial customers, including military and other Federal installations, that event would have had an enormously disruptive effect on the continuity and the operational capability of the Federal activities at those defense installations.

Senator STABENOW. So, in other words, rather than a direct impact, you are looking at the broader impact of what was happening in California.

Mr. FYGI. The broader impact and the consequential impacts, were the sequence of events that was predictable under California law, to have unfolded in that worst possible way. And the object of the order was to prevent that sequence from occurring.

Senator STABENOW. Okay. Thank you, Mr. Chairman.

Chairman GRAMM. Thank you. Let me just try to summarize some concerns.

I think we really came very close to getting down to the question that this Committee is going to have to examine when you answered my question about the situation of defense facilities with back-up electric generation.

They are not buying gas from PG&E, but PG&E is delivering the gas in many cases, not all cases, but in many of the cases. And PG&E, under a State mandate, puts the retail consumer, the homeowner, at the top of the cue.

I was not here when this bill was drafted. But I had one of my trusty staff members go out and look at the photos of our chairmen. If you want to get some humility, all you have to do is look at those photos. I am embarrassed to say that I do not know Burnet Maybank, who was chairman of this Committee from 1949 to 1952, when this bill was written.

But it seems to me that what the Committee must have had in mind when they wrote the law was exactly the situation you are talking about, to the following extent. And that is, you have these defense installations and a policy of preempting gas shippage, even though the utility doesn't own the gas, which is a legal question in and of itself in my mind—that you would preempt the gas even though PG&E does not own it for civilian use.

My guess is that Senator Maybank probably thought, well, we are talking about a period where we have some conflict going on in the world or where something critical is happening.

And second, my guess is that he envisioned, and the Congress envisioned, that the use of the Defense Production Act would be to say to PG&E, you cannot preempt this gas for civilian use. It has to flow through to these military installations.

I am sorry that Senator Maybank is not here to answer our question; I am sure he is, too.

[Laughter.]

But what we have now decided—and your answer, I think, was very instructive—is that military need that was not our only objective here. We could have easily resolved the defense problem. But our objective was beyond that, to affect the civilian situation there.

And at least it seems to me, and I know you can argue these things endlessly from a legal point of view, but when the law says in Section 101(a) that the President is authorized to use this provision only where necessary or appropriate to promote national defense, then it should not be used to accomplish purposes, however meritorious, which bear no relation to national defense.

It seems to me that very real example is where we call into question of where it is appropriate to use this law and where it is not.

Mr. FYGI. Mr. Chairman, as to strictly a question of law, the statute in 101(a) does not use the word only. Perhaps you are reading from an element of the legislative history.

Chairman GRAMM. It has a quotation mark around it. But it could be.

I am not trying to get into a legal argument.

It seems to me the question that we have to ask ourselves in the year 2001, is whether there ought to be a higher standard for taking people's property and allocating resources and dictating price, and whether any President should be delegated such powerful responsibilities. In the middle of a war, where decisions have to be made every day, I think you can understand that.

But in peacetime, I think one of the questions that we are going to have to ask ourselves is not a question of whether the law applied to this situation. I would say that there is a question of whether the law applied to the circumstance.

A legal argument could be made if we were arguing in front of the Supreme Court, and I think I could make a strong argument.

But given how the law has been used in the past, my guess is you might win that case. But we are in the business of making law, and not debating how it should be interpreted.

Mr. FYGI. Justice Scalia has said as much in his concurring opinion.

Chairman GRAMM. And it seems to me that this is something that we need to look at.

I want to thank both of you for coming today. This has been a very good hearing. I would have to say that this is a complicated issue, not one we deal with every day.

The Congress has routinely extended the Defense Production Act without taking a comprehensive look at it, except to add some tangential energy powers during the energy crisis of the 1970's. And I think that one thing that this example makes very clear is that this is something that we should not do in the future.

We are not going to extend the Defense Production Act as it is now written. It is either going to die or it is going to be dramati-

cally rewritten because whether a President can appeal to precedent or not, in a free society, in the midst of peacetime, it ought to be an extraordinary action, in my opinion, for the government to be taking people's property and dictating prices.

There ought to be comprehensive, detailed findings. It should be a decision made by the President under the strictest constraints. And again, you took the law as it was, precedents as they were. You made a decision. We can debate about its being right or wrong. You make a strong case for your side. But what we have to decide is how do we want it to be in the future.

I want to thank you for your testimony. It is been very helpful and very instructive. And in listening to you, it reminds me of something we often forget. And that is, there are a lot of people in the Federal Government that have extraordinary ability and while we generally do not know their names, they provide great service to this country.

I want to thank both of you for coming today because I think this has been, for what we are trying to do—not to affix blame, not to say, this was a Democratic Administration or Republican Administration—basically to take a long, hard, dispassionate look at this old law written in a very different world, whether we want this law to continue to operate, not as Burnet Maybank may have written it or envisioned it, but as it has been applied.

This is the decision we have to make. And your testimony has been very, very beneficial, and I want to thank you.

The Committee stands adjourned.

[Whereupon, at 11:29 a.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT SENATOR MICHAEL B. ENZI

I would like to thank the Chairman and the Committee for holding this hearing today. This hearing provides the Senate an opportunity to look at, and learn more about, the impact that the implementation of one of our Nation's Federal defense powers, the Defense Production Act, has had on private individuals in each of our respective States. To fully understand what is going on in the West and the way the decision to use this act to bail out California's energy market is perceived in Wyoming, one must first realize the large shadow California already casts on its neighboring States.

In the West water is king. As the snows melt along the Rocky Mountains and flow into the Colorado River, then out to the Pacific Ocean, each State along the Colorado River Basin has certain legislated water rights that are carefully laid out in a specific order of hierarchy. Over the years, many of these rights have existed on a purely speculative level. Even though the full capacity of those rights have not been developed, the rights, nonetheless, have been maintained with the understanding that someday these States will eventually use their full share of the water. Southern California, however, developed its water rights early and often.

While the rest of the area has been slower to develop, California experienced an early rapid economic growth and a large population influx that often resulted in the State's demands for Colorado River water to exceed its allocated rights. As California has never been bashful about going after water to feed its ever-growing economy, Western States perceive California as a huge straw that sucks the water out of the other Western States.

The question that must be asked about the California energy crisis, is "Is this another California straw?" Will the rest of the West now be forced to provide for all of California's energy needs just as we provide for the State's water?

This is a very real fear, especially in light of the fact that by invoking the Defense Production Act that ordered energy contractors to deliver energy to California residents, the Federal Government not only required contractors to put aside their regular free market remedies for customers who can't pay their bills, but the Defense Production Act makes the duty to deliver those goods and services a superior priority to all other contracts. Had a conflict arisen between providing energy for California and any of the companies' other contracts, such as for the States of Oregon, Nevada, Idaho, Arizona, New Mexico, or Wyoming, then the Defense Production Act would have required the contractors to fill California's demands first. Only after California is adequately provided for could any energy left over be used to fill the needs of other States.

The questions presented by this Committee as it reviews the implementation of the Defense Production Act are whether or not the Act was used properly, and what the possibilities of using this Act are in the future. While I am certain that these are appropriate questions, I can't help but recognize that the real issue underlying the California Energy Crisis has more to do with a failure to develop a national energy policy than it does with the short-term efforts employed to fend off economic disaster.

California's version of deregulation shows the same inherent weakness that exists in the direction that our Nation is currently heading toward when it comes to the development of domestic energy supplies. The California system prohibited any new power plant construction for many years and encouraged companies to take existing plants off line. This occurred even though experts accurately predicted that California's energy and electricity needs would continue to grow and outpace supply.

The comparison between California and the rest of the Nation is almost frightening. For the past several years the national trend has been to shut down efficient and steady coal-fired power plants, thereby decreasing our Nation's base load of electricity supply, and to replace those plants with the now popular natural gas plants. The result has been that no new coal fired plants are scheduled for construction, and the natural gas plants that were supposed to be our saving grace, are now being priced out of the market because of the astronomical leap in the cost of natural gas. When you couple this decline in power production with a projected nationwide increase in demand for electricity to fuel our new high-tech economy, you begin to realize that there is vast potential for the current California emergency to spread to the rest of the United States.

We have got to stop focusing on the symptoms and start dealing directly with the disease. Short-term economic band aids and artificially controlled prices will only make the situation worse. Our goals of establishing stability and prices that are truly market based can only be reached by acting on a plan that allows us to better meet our own energy demands.

Mr. Chairman, I am again grateful to you and the Committee for holding this hearing. I hope that we can use this opportunity as a starting point for restoring stability to our Nation's energy market.

PREPARED STATEMENT OF ERIC J. FYGI

ACTING GENERAL COUNSEL
U.S. DEPARTMENT OF ENERGY

FEBRUARY 9, 2001

Mr. Chairman and Members of the Committee: I am pleased to appear before the Committee in response to its request for testimony by the Department as to the circumstances and analyses that prompted the Department to employ the Defense Production Act of 1950 in responding to actual and threatened interruptions of natural gas supplies in northern and central California in January of this year. I am accompanied by Paul F. Carrier, the Director of the Office of Energy Emergencies in the Department's Office of Policy.

The circumstances that gave rise to the interruption of natural gas supplies in northern and central California actually began with the cumulative effects of electricity sales within the State under California's 1996 electricity restructuring legislation. Under that structure State-regulated electric utilities were required to sell electricity to their customers at frozen rates that could not be adjusted upward to reflect increased acquisition costs of wholesale electric power. At the same time, the State required PG&E and other State-regulated electric utilities to purchase their electricity supplies in the day-ahead or real time spot market (in contrast to long-term contracting, which permits hedging), provided for partial divestiture of the utilities' fossil generation assets, and required utilities to sell their electricity into the Power Exchange rather than use it to serve their customers. In addition, growth in electricity demand far outpaced growth in electricity supply. Between 1996 and 1999, demand in California rose 5,500 MW, while supply rose only 670 MW. This combination of factors—and the constraints on hydropower throughout the Northwest—put the utilities in the position of buying wholesale power for as much as 30 cents per kilowatt-hour, while only being allowed to sell it for 7 cents.

Beginning in May 2000, State-regulated electric utilities began to accumulate huge debts in the form of unrecovered wholesale power costs as a result of the rate freeze. These unrecovered wholesale power costs significantly weakened the financial health of the utilities and, in many cases, the utilities approached insolvency. PG&E's debts alone totaled \$6.6 billion.

The reluctance of electricity generators and marketers to sell to PG&E and Southern California Edison, the other major State-regulated electric utility that accumulated large unrecovered wholesale power costs, deepened as the financial condition of the utilities worsened. In order to prevent loss of electricity supplies to the customers of the utilities, then-Secretary of Energy Richardson issued an emergency order under the Federal Power Act on December 14, 2000 directing certain electricity generators and marketers to continue to sell electricity upon request by the California Independent System Operator, a nonprofit corporation established by the 1996 California electricity restructuring law charged with operation of the transmission system and assuring system reliability in California. This emergency order was extended to 3 a.m. EST on February 7, 2001.

The poor financial condition of PG&E also led some natural gas suppliers to terminate sales to the utility, out of concern that the losses the utility was incurring in its electricity operations would lead to insolvency, notwithstanding the fact that PG&E's gas operations themselves could recover costs under its tariff. Unlike Southern California Edison, PG&E is both a gas and electric utility.

On January 9, 2001, one supplier, which supplied approximately 14 percent of PG&E's core gas supplies, terminated sales to PG&E. Other gas suppliers soon followed suit, still others threatened to stop deliveries absent prepayments or credit guarantees. About 25 percent of PG&E's January baseload supply of natural gas was terminated and substantial additional volumes were threatened.

PG&E serves 3.9 million "core" gas customers in California, both residential consumers and small businesses. PG&E also transports natural gas to about 5,000 "noncore" customers, including industrial consumers and electricity generators. Electricity generation accounts for roughly two-thirds of noncore gas consumption. If PG&E experienced a shortage in gas deliveries, it would have to increase withdrawals from gas already in storage and divert gas from noncore customers. Diver-

sion from noncore customers would exacerbate the California electricity shortage, since two-thirds of PG&E's noncore gas is used for electricity generation.

PG&E and Southern California Edison first sought redress at the State level by applying to the California Public Utilities Commission for retail electricity rate increases. On January 4, 2001, the California Public Utilities Commission increased retail electricity rates by a surcharge of one cent a kilowatt-hour among its classes of customers. It did so for a period of 90 days, and did not otherwise alter the rate freeze under which PG&E and Southern California Edison were operating. PG&E also sought action from the State to prevent a loss of gas supplies. PG&E asked the California Public Utilities Commission for emergency authorization to draw on the gas supplies of the other major gas utility in the State. As of February 7, 2001, the California Public Utilities Commission had not acted on this request.

On January 10, 2001 PG&E and its parent filed a Form 8-K with the Securities and Exchange Commission in which they announced suspension of dividend payments and postponement of release of financial results for the fourth quarter of 2000. The stated reason for postponing release of financial results was that the outcome of then on-going State and Federal efforts involving the California electricity market could result in measures that "significantly and adversely affect" PG&E Corporation's financial results.

Beginning the first week in January, the Department was advised by PG&E's General Counsel that debt rating agencies had reacted negatively to the California Public Utilities Commission's January 4 Order, and that if PG&E's outstanding debt were reduced to junk status that event would constitute a default under PG&E's various natural gas supply contracts. Were that event to occur it would accelerate the payment obligation of all of PG&E's natural gas supply contracts. While we understand that at the time PG&E had acquiesced in pre-paying some of its natural gas suppliers, the normal payment schedule of PG&E was that its contracts required payment in full on the 25th day of each month for the entire prior month's deliveries of natural gas to PG&E for sale to its gas customers. While PG&E's tariff with the California Public Utilities Commission enabled it to recover the full amount of increased acquisition costs for natural gas resold by PG&E (unlike the case for electricity), because of PG&E's precarious operating revenue posture stemming from the electricity market, PG&E indicated that it could not continue to purchase the needed volumes of natural gas if it were required to pre-pay for them.

At about the same time, beginning January 9, 2001, then-Treasury Secretary Summers and then-Energy Secretary Richardson participated in extensive meetings that included the Governor of California, California legislative leaders and the President of the California Public Utilities Commission, the CEO's or Presidents of the major California electricity suppliers, and the CEO's of the California investor-owned utilities or their parents. While the objective of these meetings was to assist the State of California in formulating a solution to the evolving situation, no such solution was announced.

On January 12, 2001 the CEO of PG&E formally requested President Clinton to invoke emergency authorities in order to assure continuity of natural gas supplies through PG&E to its service territory in northern and central California. That letter was accompanied by an affidavit executed the same day by the Chief Financial Officer, Treasurer and Senior Vice President of PG&E that described in detail the circumstances giving rise to the threatened interruption of natural gas supply through PG&E to northern and central California. On January 13, 2001 Governor Davis sent a letter to President Clinton in which the Governor described his inquiry into the circumstances, his finding that there was an "imminent likelihood that natural gas supplies in northern and central California will be interrupted," and requested the assistance of the President and the Secretary of Energy on an urgent basis.

On January 15, 2001 then-Deputy Energy Secretary Glauthier conducted a telephone conference that included operational executives of PG&E in order to ascertain further the logistical and operational circumstances that necessitated immediate action at the Federal level. On January 16, 2001 Reuters reported that Standard & Poor's had downgraded PG&E's debt to "low junk" status. President Clinton's instructions to the Secretary of Energy, and the Secretary of Energy's accompanying Order to PG&E and its natural gas suppliers, were issued on January 19, 2001. As the text of each document indicates, their issuance was based not only on the emergency provisions of the Natural Gas Policy Act of 1978, but also on the Defense Production Act of 1950. I now turn to the reasons that prompted the Department to formulate this approach.

When it appeared in early January that it might prove necessary to formulate emergency orders for continued delivery of natural gas through PG&E, we first examined the emergency provisions of the Natural Gas Policy Act of 1978, 15 U.S.C. 3361-3364. Those provisions appeared useful in that they authorized designation of

continued use of natural gas for electricity generation as a “high-priority use” in an emergency, and authorized specification by the Federal Government of the “terms and conditions” including “fair and equitable prices” for natural gas delivered under an order. The ability to determine that continued use of natural gas was a “high-priority use” under the Natural Gas Policy Act was quite important because, without such Federal action, under California law, any reduction in gas volumes available to PG&E as merchant impairing its ability to serve its “core customers” (residences and small businesses) would result in mandated redirection of gas volumes delivered through PG&E (but not owned by it) destined for noncore customers, including most significantly electricity generators. Were such redirection to occur it would have further reduced the volumes of natural gas available for electricity, generation in California.

Despite the technical utility of Section 302 of the Natural Gas Policy Act, 15 U.S.C. 3362, in these respects, we remained concerned that it only would “authorize” purchase, rather than also to require deliveries, of natural gas to enable PG&E to continue to distribute sufficient volumes of natural gas. During January PG&E advanced arguments asserting that the allusion to an “order” in Section 302 suggested that it embraced an ability to impose a supply mandate. Based on textual analysis of the Natural Gas Policy Act we remained unpersuaded on this point. In forming our view of this question we also consulted with an attorney of the Federal Energy Regulatory Commission who had been designated by the Commission’s General Counsel to aid us in our examination of this question. Our textual analysis coupled with that of the Federal Energy Regulatory Commission attorney, together with our understanding of the provenance of Section 302 as having had the original objective simply of permitting emergency sales into interstate commerce by nonjurisdictional gas producers without becoming thereby subject to then-existing wellhead price controls, prompted us to conclude that the Natural Gas Policy Act’s emergency provisions, standing alone, would not suffice if the Federal Government were to mandate continuity of natural gas deliveries through PG&E to all of its service territory in northern and central California.

We then considered whether the Defense Production Act provided the authority to complement the emergency provisions of the Natural Gas Policy Act such that the entities (largely resellers and not producers), had recently provided PG&E with natural gas could be directed to continue to make similar volumes available to PG&E. We concluded that the Defense Production Act would provide this authority.

Title I of the Defense Production Act authorizes the President to require the priority performance of contracts or orders in certain circumstances. Under Section 101(a), 50 U.S.C. App. 2071(a), the President may require performance on a priority basis of contracts or orders that he deems “necessary or appropriate to promote the national defense.” In determining what the national defense requires, it is clear the President may consider the potential impact of shortages of energy supplies. In the Energy Security Act Congress specifically designated energy as a “strategic and critical material” within the meaning of the Defense Production Act and also added language to its Declaration of Policy that establishes a link between assuring the availability of energy supplies and maintaining defense preparedness. The Defense Production Act’s Declaration of Policy, 50 U.S.C. App. 2062(a)(7), states:

[I]n order to ensure national defense preparedness, which is essential to national security, it is necessary and appropriate to assure the availability of domestic energy supplies for national defense needs.

PG&E’s customer base in northern and central California includes a number of defense (including “space,” as the term “defense” is defined in the Defense Production Act) installations and defense contractors that use natural gas and electricity and that clearly would be adversely impacted by interruption of natural gas service. Continuity of supply to these facilities was threatened in the same fashion as other industrial natural gas consumers in PG&E’s service territory.

Section 101(c) of the Defense Production Act, 50 U.S.C. App. 2071(c), authorizes the President to require priority performance of contracts or orders for goods to maximize domestic energy supplies if he makes certain findings, including that the good is scarce and critical and essential to maximizing domestic energy supplies. In the situation existing in California in mid January, natural gas supplies would have become acutely scarce had the withholding by PG&E’s suppliers continued and expanded to more suppliers than those that already had terminated deliveries. Moreover, continuity of natural gas supply is critical and essential in PG&E’s service area to electric energy generation, petroleum refining, and maintaining energy facilities. These factors seemed directly to bear on the terms of Section 101(c) of the Defense Production Act relating to continuity of energy production.

Accordingly, we structured the emergency natural gas order to include the supply obligation authorized by the Defense Production Act. Our understanding of the Defense Production Act regime was that it is broad enough to embrace mandates for priority performance of new orders to vendors, as well as priority performance of existing contracts. Thus this authority fit well in a transactional sense in which some vendors' contracts to supply gas might have expired by their terms just before the order.

This aspect of the Defense Production Act regime permitted the Department to impose a temporary supply assurance for natural gas to northern and central California comparable to that done with the electricity orders for the area of the State served by the California Independent System Operator by the Department's prior orders under Section 202(c) of the Federal Power Act. The Department's emergency natural gas order was directed just to the group of suppliers that had provided PG&E natural gas on commercial terms during the 30-day period prior to issuance of the order. This approach was chosen as the least intrusive means that would achieve the public health and safety and defense preparedness objectives of continuing for the near term natural gas supplies into PG&E's service area. The order is best understood as an emergency, temporary action designed to afford California the opportunity to abate the emergency by its necessary further actions.

This concludes my prepared statement. Mr. Carrier and I will be pleased to respond to any questions the Committee may have.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR GRAMM
FROM ERIC J. FYGI**

Q.1. In the Federal Order issued by former Energy Secretary Richardson on January 19, 2001, and extended by Secretary Abraham on January 23, 2001, the authorities under both the Natural Gas Policy Act of 1978 and the Defense Production Act of 1950 were used. The Order listed four items: (1) Authorized Pacific Gas & Electric to purchase emergency natural gas supplies; (2) required suppliers that had contracted with Pacific Gas & Electric within 30 days of the Order to supply natural gas to Pacific Gas & Electric under terms consistent with those previous contracts, with the exception of terms requiring accelerated payments, prepayments, or other “extraordinary payment terms;” (3) required that the natural gas purchased by Pacific Gas & Electric be used only for sale by Pacific Gas & Electric for “high priority” uses; (4) required Pacific Gas & Electric and their suppliers to submit a weekly report listing the volumes and prices of the natural gas delivered, transported, or contracted under the order to the Department of Energy. Which part(s) of this order would not have been possible had the authorities under the Defense Production Act not been used?

A.1. The element of the emergency orders requiring PG&E’s natural gas vendors to continue supplying PG&E volumes of natural gas conforming to then-current or recent commercial contracts with PG&E was premised on the Defense Production Act. Although PG&E advanced a legal argument that the text of Section 302 of the Natural Gas Policy Act might have authorized this element of the emergency order, we concluded it was legally prudent to include reliance on the Defense Production Act in view of its clearly-established authority to require priority performance of existing contracts with, and priority fulfillment of new orders by, entities receiving priority assistance under the Defense Production Act.

Q.2. The Federal Order specified the terms of the contract between Pacific Gas & Electric and the suppliers affected by the order, as those that are consistent with the terms of previous contracts in existence within 30 days of the order, with the exception of “extraordinary payment terms.” This specification of contract terms had the effect of setting the prices of natural gas to be sold under the Order.

A.2. We do not agree that the emergency orders’ requirement that natural gas continue to be provided to PG&E on terms consistent with the regular commercial prices in PG&E’s contracts with its natural gas vendors constituted the “setting [of] prices” by the emergency order.

Q.2a. Was the Natural Gas Policy Act or the Defense Production Act used to set prices under the Order?

A.2a. To the extent that it might have proven necessary to “set prices” under the emergency order, the authority to do so would have been the Natural Gas Policy Act.

Q.2b. Did any of the contracts require or allow the supplies to be paid a higher price for natural gas if Pacific Gas & Electric’s credit worthiness came into question? If so, which suppliers held such contracts and what would the price have been?

A.2b. We do not know whether any of the inventory of contracts between PG&E and its gas vendors provided for per-unit price escalation in the event of a credit worthiness problem. Instead our understanding was that, in such an event, some contracts might have accelerated the timing of PG&E's payment obligation (collapsing the prior normal payment interval of net—25th of the month—for the next prior month's deliveries) or provision of external credit guarantees. Our understanding also was that some vendors holding individual recently-expired contracts with PG&E were requiring, as a condition of future deliveries, advance payments or third-party credit guarantees which PG&E could not then provide. Imposition of the up-front payment and credit guarantee requirements was not feasible because, although PG&E's natural gas tariffs for its sales of natural gas allowed full recovery of its natural gas acquisition costs, in its electricity revenue-starved situation PG&E could not either advance funds for paying for its natural gas acquisition costs before receiving its revenues from those sales or secure new credit guarantees.

Q.2c. If the contract signed by the supplier and the purchaser required or allowed a different price to be charged under different conditions, such as a reduction in the buyers' credit rating, can a price required under the existing contractual agreements be considered an "extraordinary payment"?

A.2c. We are not aware of any such contracted-for price differential. None was presented to us during the period the emergency orders were in effect. The only question regarding the economic terms of the emergency order was presented by a unit of Goldman Sachs, which is described in the attached order.

Q.2d. Regarding those natural gas sales where the Defense Production Act authority was invoked, if the existing contractual agreement requires a specific price to be paid under certain conditions and if those conditions exist, how can the Department of Energy order prohibit that contractual price and impose another price without violating the statutory ban on the "imposition of wage or price controls"?

A.2d. As was stated above, the emergency orders did not purport to impose general price controls. To the contrary, they embedded in their terms the regular contract prices currently and recently (in the next prior 30-day period) charged by natural gas vendors to PG&E. No disagreement of the price to be charged PG&E was brought to our attention by the natural gas vendors or by PG&E. Therefore the Department had no occasion to impose sales prices by vendors of natural gas to PG&E under the orders, and the orders instead incorporated simply the current and recent (within the prior 30 days) contract sales prices between PG&E and its vendors.

Q.2e. If the Department of Energy can mandate suppliers to provide natural gas based on the contracted prices of the last 30 days, and have such a mandate not be considered a price control, could not the Department of Energy require suppliers to use the contracted price of 2 years ago and still maintain that this is not a price control?

A.2e. As was stated above, there was no specified price in the emergency orders requiring continuity of supply to PG&E on normal commercial contract terms. We do not understand the Defense Production Act as a device that would permit any rollback “price control” of the sort that is suggested in the question. None was considered or imposed in the California emergency natural gas orders.

Q.3. While it is necessary for the President to declare an emergency under the Natural Gas Policy Act, such a formal declaration was not used for the Department of Energy to invoke the Defense Production Act to allocate materials or to set the priority performance of contracts.

A.3. The emergency declaration by President Clinton was necessary to invoke the emergency provisions of the Natural Gas Policy Act. That is because President Carter’s 1980 delegation withheld from the Secretary of Energy the authority to make the emergency finding necessary to invoke these authorities. Therefore invocation of the emergency authorities of the Natural Gas Policy Act was dependent on the President’s January 19, 2001 finding.

Q.3a. Why was President Clinton’s January 19, 2001, White House Memorandum needed in order for the Department of Energy to exercise its authorities under the Defense Production Act?

A.3a. The President’s Memorandum of January 19, 2001 was necessary to instruct the Secretary of Energy as to the authorities he should employ to meet the declared natural gas supply emergency in northern and central California, and procedurally how to use those authorities in this emergency setting.

Q.3b. In your view, did the Memorandum waive the Department of Energy’s own regulatory procedures for implementing the Defense Production Act?

A.3b. The President’s Memorandum, by its terms, supplanted for this emergency period internal governmental procedures otherwise stemming from the various prior executive orders relating to use of the Defense Production Act in its normal, nonemergency application. Those procedures are structured for nonemergency application of the Defense Production Act priority assistance authority, and have the effect of minimizing governmental intrusion into the general economy.

Q.3c. Is it your opinion that the Memorandum properly waived the requirements of Executive Orders 11790 and 12919?

A.3c. The President’s Memorandum speaks for itself, and we have no occasion to doubt its legal effectiveness in governing the manner it specified for action by the Secretary of Energy in carrying out the statutory authority vested in the President.

Q.3d. Are Executive Orders 11790 and 12919 still in effect, or did the White House Memorandum permanently waive the requirements of those orders?

A.3d. Executive Orders 11790 and 12919 remain in effect for the general and regular administration of the Defense Production Act. The provisions of the President’s Memorandum of January 19, 2001 by their terms apply only to the natural gas emergency in northern and central California that was declared pursuant to Section 301

of the Natural Gas Policy Act. Unless extended by further action by the President, such an emergency declaration expires 120 days after its issuance.

Q.4. Were alternatives to using the Defense Production Act in the context of Pacific Gas & Electric's inability to purchase natural gas evaluated by the Department of Energy or, to your knowledge, any other governmental entity? Did the Department of Energy consider, for example: Using the Defense Production Act to force Pacific Gas & Electric to prioritize transmission-only service for defense installations and defense contractors in order to ensure that their natural gas supplies would not be confiscated and redirected for core customer use?

A.4. This approach was not seriously considered. It would have constituted an attempt at Federal micro-management incompatible with the emergency circumstance that was presented. The unknown collateral effects of permitting events to work their will under such a limited approach likely would have had adverse operational effects on defense-related facilities and activities that such an approach would not have accurately predicted.

Q.4a. The ability of the California Public Utilities Commission to order the "ring-fencing" of natural gas accounts receivables to be used as collateral by Pacific Gas & Electric so that they may continue to enter into natural gas purchase contracts with their suppliers?

A.4a. When the likelihood of interruption of natural gas supplies to PG&E was brought to our attention in early January and confirmed formally in PG&E's and the California Governor's January 12 and 13, 2001 correspondence to President Clinton, the California Public Utilities Commission had yet to take action that would segregate PG&E's natural gas receivables. After the emergency orders were issued the California Public Utilities Commission did so, on January 31, 2001.

Q.4b. The ability of the California Public Utilities Commission to issue an order, similar to the Federal Order, requiring other California natural gas local distribution companies regulated by them to sell natural gas to Pacific Gas & Electric?

A.4b. While we were aware that PG&E had made an emergency request on January 18, 2001 for an order directing Southern California Gas Company to provide "mutual assistance," that is, to sell gas to PG&E for PG&E's core customer needs, the California Public Utilities Commission had not entered such an order at the time the Department issued either of its emergency orders.

Q.4c. An emergency facilitation of contracts between Pacific Gas & Electric's core customers and others that purchase natural gas directly from Pacific Gas & Electric, and alternative natural gas distributors, producers, marketers, or traders, using Pacific Gas & Electric for transmission-only service?

A.4c. We do not understand what is meant by "emergency facilitation" between "core customers," and "others," and "alternative natural gas distributors, producers, marketers, or traders." We were unaware of any "emergency facilitation" authority that was available here, and the question's terms imply the desirability of some

sort of omnidirectional consultation instead of taking decisive executive action deemed necessary to deal with an emergency placing millions of natural gas consumers and electricity consumers at risk of breakdown in service.

Q.4d. Allowing Pacific Gas & Electric to reorganize or liquidate through bankruptcy?

A.4d. The potential of relying on a voluntary bankruptcy scenario was evaluated informally in connection with this emergency. This evaluation indicated two conclusions: (1) The reorganization provisions of the Bankruptcy Code generally are useful for a going concern when its operating revenues cover its operating costs, but when the concern's threatened insolvency stems from a significant negative operating cash flow (as appeared to be the case with PG&E), reorganization under bankruptcy protection is not an assured pathway to continued near-term operation of the utility; and (2) under the Bankruptcy Code, neither a reorganization nor a liquidation bankruptcy proceeding could afford the bankruptcy court the unilateral ability to raise customer electricity rates without approval by the California Public Utilities Commission.

Please furnish the Senate Banking Committee with copies of the Department of Energy's, or any other governmental entity's, evaluations of all alternatives considered, including those listed above.

As was described in the Department's testimony for the February 9, 2001 hearing, the matter was presented to the Department as an emergency circumstance. Much of the inquiry was done orally by and among senior officials of the prior Administration, and was directed to understanding the need for immediate action rather than simply awaiting the next Administration. The evaluation of alternatives was not preceded by documentation of this sort, although one document summarized the situation for the then-head of the National Economic Council. The legal evaluation was done through submitting the text of the proposed Presidential Memorandum to the Office of the Counsel to the President and the Justice Department's Office of Legal Counsel. Because of the emergency nature of the matter (with additional delivery interruptions anticipated on January 19, 2001), the legal evaluation was directed to the draft text of the President's Memorandum itself without ancillary written analyses. The legal evaluation was expressed orally during a conference call among the responsible DOE General Counsel attorneys and those in the White House Counsel's Office and Justice's Office of Legal Counsel.

Q.5. In his letter dated January 9, 2001, the President of Pacific Gas & Electric indicated that the natural gas crisis was "a credit-based shortage, not a physical supply shortage." In assessing possible credit assistance to Pacific Gas & Electric, the California Electricity Oversight Board determined that the California Constitution prohibited any guarantee or credit backing by the State of California to Pacific Gas & Electric. Yet numerous credit and loan guarantee programs are available to private parties throughout the State of California on a wide range of activities. Given the numerous State-sponsored loan, loan guarantee and financing programs, why was it deemed unreasonable for any of these State programs

to be utilized, redirected, or similarly created, in order to address the credit problems of Pacific Gas & Electric?

A.5. Whether it would have been reasonable for the State of California to establish a credit or loan guarantee program to assure continuity of natural gas supplies in northern and central California is not a question on which this Department formulated a position. Instead the Department was confronted in January 2001 by the fact that, in the view of the California authorities, such financial assistance could not be immediately forthcoming. The Department's action was taken to stem a "run on the bank," and by its terms was temporary in nature and therefore did not indicate the Department's view whether such State-granted credit or financial guarantees were a proper measure for the State to initiate.

Q.6. The Department of Energy generally uses its authority under the Defense Production Act to force the prioritization of contractual agreements already in place between buyers and suppliers that also include agreed upon terms, including quantities and prices. In this case, the Department of Energy used the Defense Production Act to force natural gas sellers to sell to Pacific Gas & Electric even if there were no existing contracts in place. Does Section 101(a) of the Defense Production Act apply only to the prioritization of contracts or does it also grant authority to force sellers to enter into a new contract or to extend a contract, or to compel a sale even where no sale to any party was contemplated by the supplier? Please explain.

A.6. Section 101(a) of the Defense Production Act, by its terms, authorizes priority performance of both existing "contracts" and priority performance of new "orders" for "materials." This structure indicates that the authority of Section 101(a) is not limited to the performance of existing contracts. It also suggests, however, that the obligor to the recipient of priority assistance filling a new "order" is in the regular commercial business of providing to commercial buyers the "materials" that are the subject of the order.

Q.6a. Has the Department of Energy ever used the Defense Production Act to force suppliers to sell to purchasers without the existence of a contractual agreement between the two parties? Please furnish the Committee with the details, including the dates and parties involved, of all instances in which the Defense Production Act was used to force the initiation or the extension of a contract.

A.6a. The available records that document the Department's historical use of the Defense Production Act do not indicate whether the priority assistance was extended to performance of an existing contract or to the filling of a new order not yet memorialized in an existing contract. The records do suggest that the entities subject to priority assistance orders were in the regular business of providing the called-for materials or services to the commercial sector.

Q.6b. Consider that the Federal Government wants, or determines that there is a need for, a commodity that is generally available from the marketplace. Can the Federal Government use the Defense Production Act to require that a holder of that commodity make a sale to the government, or to some third party, even though

the holder does not, and has no intention to, make the product available for sale?

A.6b. On these facts, it is difficult to understand how the Defense Production Act might come into play. Additional, and less abstract, facts might suggest that the Defense Production Act could become relevant. If, however, a “commodity” is in fact “generally available” and in fact is made available without discrimination to entities in circumstances that meet all defense or energy-related needs, then it is difficult to understand the role of priority assistance under the Defense Production Act.

Q.7. In your view, does money and credit meet the definition of “materials, services and facilities” as it is used in Sections 101(a) and 101(c) of the Defense Production Act?

A.7. We never have had occasion to consider whether money or credit might meet the definition of “materials, services, and facilities” under Sections 101(a) and 101(c) of the Defense Production Act. In the case at hand, we viewed natural gas to be “materials” within the meaning of the Defense Production Act, and as we indicated during the February 9, 2001 hearing, we believe that the text and the legislative history of the 1950 Act support understanding the Defense Production Act to include natural gas (as well as the explicitly mentioned “petroleum”) as a “material” susceptible to priority assistance under the Defense Production Act.

Dickerson, Katharine

From: Lindh, Frank (Law) [FRL3@pge.com]
Sent: Friday, January 26, 2001 1:01 PM
To: Carrier, Paul
Cc: Skinker, Michael; Bradley, Samuel; Fygi, Eric; White, James; Bar-Lev, Joshua (Law); Kline, Steven (Corp); Anderson, David W (Law); Anderson, David W (Law); Berkovitz, Trista; Welch, Ray; Kline, Steven (Corp); Bar-Lev, Joshua (Law); Peters, Roger (Law); Boyd, Judith (SVP/GC); Harvey, Kent; Pidcock, Paulette C (Corp)
Subject: PG&E Gas Suppliers: Follow-up Q
Importance: High

Paul Carrier -

This is in response to your question today regarding the three gas suppliers — J. Aron, Sempra, and Western Gas Resources — who previously had terminated deliveries to PG&E, and who have resumed deliveries this week under the Secretary's Emergency Gas Order.

Your specific question was: What percentage of PG&E's previously-contracted January baseload supply is represented by the volumes of these three suppliers?

The answer is approximately 25%. The details are as follows:

	Total January baseload contract volume:	1,068,075
MMBtu/d.	J.Aron, Sempra, & Western volumes:	270,712
MMBtu/d	J.Aron, Sempra, Western % of total:	25.35%

In addition, I think it important to bear in mind that the total volume at risk of termination as of the date of the Secretary's Emergency Order, on January 19, actually was much larger than the volume represented by the three above-named suppliers who already had terminated as of that date.

As we informed DOE last week, the total volume at risk of imminent termination as of Friday, Jan. 19, in addition to the volumes already terminated as of that date, was as follows:

	Total January baseload contract volume:	1,068,075
MMBtu/d.	J.Aron, Sempra, & Western volumes:	270,712
MMBtu/d	Other volumes at risk of imminent termination:	205,837
MMBtu/d	Total volume terminated or imminently at risk:	476,549
MMBtu/d	% of total volume terminated or imminently at risk of termination as of 1-19-01:	44.6%

By way of background, the other suppliers who had threatened imminent termination as of Friday, Jan. 19, were Duke Energy, Coastal Merchant Energy, Texaco, Natural Gas Exchange (NGX), and Cook Inlet Energy. We are pleased to report that all of these suppliers have continued to provide contract volumes this week under the Secretary's Emergency Order.

I hope this information is fully responsive to your follow-up question. Please feel free to call or e-mail me with any further questions or concerns.

> Frank Lindh
 > Attorney
 > Pacific Gas and Electric Company
 > (415) 973-2776
 >

Sullivan, MaryAnne

From: Lindh, Frank (Law) [FRL3@pge.com]
Sent: Monday, January 15, 2001 11:16 AM
To: Skinker, Michael; Bradley, Samuel; White, James; Fygi, Eric; Schwartz, Mark; Sullivan, MaryAnne; Lindh, Frank (Law)
Cc: Bar-Lev, Joshua (Law); Kline, Steven (Corp); Peters, Roger (Law)
Subject: Customer Class Gas Flow Data
Importance: High

Mary Anne -

Per our conversation just now, and in advance of this today's noon-hour conference call (Eastern Time), below is the information you requested regarding daily gas flows to (and gas consumption by) our various customer classes during a winter day.

Frank Lindh
(415) 973-2776

* Total throughput:	3,000 MMcf/d
* Core customers:	1,500 MMcf/d
* Electric generation:	1,000 MMcf/d
* Other non-core:	500 MMcf/d

PREPARED STATEMENT OF ELI D. BEBOUT

FORMER SPEAKER OF THE WYOMING HOUSE OF REPRESENTATIVES
PAST CHAIRMAN OF THE ENERGY COUNCIL

FEBRUARY 9, 2001

My name is Eli Bebout; I'm a former speaker of the Wyoming House of Representatives, and past Chairman of the Energy Council, a group composed of legislative representatives from 10 energy-producing States, Venezuela and Alberta, Canada. It is a privilege to submit testimony into the record regarding Wyoming's perspective on the Western energy crisis.

First of all, the California energy crisis is a situation precipitated by California and its misguided effort 5 years ago to deregulate the utility industry. But instead, California's State government actually re-regulated the industry, stripping long-term power contracts from its energy companies, and prohibiting other suppliers from competing in the California energy marketplace. Instead of curbing consumer demand with open market rates, California encouraged demand with artificially low demand with open market rates, California encouraged demand with artificially low prices and spot prices. Instead of addressing their rising energy consumption by the construction of additional power plants, Californians ignored their power deficit, and created almost impossible hurdles for plant siting.

So now the California power crisis is both a Western States problem and a national concern. Wyoming and other western States cannot ignore the fact that the western power grid has linked all of us to the California energy situation, and the grid is both part of the problem, and part of the solution.

I am in agreement with Wyoming's Senator Mike Enzi who stated that President Clinton's solution to the problem was inappropriate. His sanctioning the National Defense Act of 1950 to force companies to continue providing natural gas to a heavily indebted California public utility was a misuse of that law. The law was written to protect national security in a time of war. And as Senator Enzi correctly stated, it would have given California an unfair power priority over every other western State. I was glad to see that President Bush ended that order—it is time to think about other solutions—both in the near and the long term.

The Western Governors' Association has considered the energy crisis at length, and their recommendations are worth reviewing. Many of the short-term solutions fall in the California jurisdiction—conservation measures and consumption shifting must come first. The most critical thing California must do as soon as possible is remove the impediments to a free marketplace—allowing California power companies to enter into long term power contracts, adopting rate reforms that will more accurately reflect actual costs. The free marketplace must allow true competition in the electrical grid—so there is direct access to the market for all buyers and sellers. The rate changes might be painful for California consumers at first, but the solutions have to start in California. The other part of the problem is the lack of a national energy policy. So in the long-term, there is much that we can all work toward.

The Energy Council has developed a proposal for a national energy policy, and that will be presented to the appropriate national Energy Subcommittee in March. Many of the recommendations found in that proposal are similar to those being discussed by Senator Murkowski, which include focusing on natural market forces and increasing the supply side of the power equation. I also know our Wyoming Senators are working with Senator Murkowski on this.

On the supply side, we can streamline the cumbersome regulatory processes to site and build new power-generating plants, particularly in Wyoming—not jeopardizing any part of the environment—but working together more efficiently and quickly, pulling together State, local and tribal governments to act on these issues. We can reactivate retired generating plants, and get additional energy from those areas. Homeowners can be encouraged to install their own small systems, such as wind turbines, fuel cells, and solar. In fact, the Wyoming legislature is working on a bill to help in this area. We can supplement research and development for promising renewable energy technologies and enable exploration and development of promising domestic oil, natural gas, coal, geothermal, or wind resources. We can improve our energy infrastructure with additional gas pipelines, power plants, and extensive power database to help predict and manage demands. We need access to our Federal lands to allow responsible development, in an environmentally-sound way, of the tremendous natural resources that are available.

On the demand side, we can accelerate the development of more energy efficient products in the marketplace, and adopt building codes that will improve conservation. More information and tax incentives for energy conservation could be provided to individuals.

To sum up, the crisis started in California, and the solution has to start in California. Wyoming—the BTU capitol of the Western Hemisphere—will continue to provide as much energy as it can to its neighboring States. But as a Nation, *we need a national energy policy*, and it should remove impediments to new powerplants, allow suppliers to compete in the marketplace, provide incentives for the development of alternatives energy sources, and encourage conservation.



Department of Energy
Washington, DC 20585

Supplemental Emergency Natural Gas Purchase and Sale Order
directed to
Pacific Gas and Electric Company
and
J. Aron & Company

Pursuant to the January 19, 2001, Memorandum for the Secretary of Energy from the President, "Electric Energy Shortage in California," and the authorities previously vested in the Secretary of Energy, an Emergency Natural Gas Purchase and Sale Order (Order) was issued on January 19, 2001 requiring suppliers listed in Attachment B of the Order to sell natural gas to Pacific Gas & Electric Company (PG&E) under terms consistent with any contractual arrangements in existence between PG&E and the suppliers listed in Attachment B (including arrangements between PG&E and suppliers' affiliates) at any time within the past 30 days, but subject to the conditions that (a) no accelerated payment, prepayment or other extraordinary payment terms may be imposed or invoked by any supplier, and (b) no termination by any supplier shall be permitted during the term of this Order without the agreement of the parties or the approval of the Secretary.

On January 22, 2001, J. Aron & Company (J. Aron) sent a letter to the Secretary of Energy, a copy of which is attached hereto, stating that "in accordance with our reading of the Order, we are entitled to and will require a standby letter of credit or other collateral to secure PG&E's performance of their obligations" under arrangements made pursuant to the Order. J. Aron further stated that PG&E "has refused to engage in a meaningful discussion of our request, stating instead that our prior contract has been reinstated and that, in light of the Order, we are not entitled to seek a standby letter of credit or other collateral security." J. Aron requested the Secretary of Energy, pursuant to Ordering Paragraph 3 of the Order, to "set such disputed terms."

Given the language contained in Ordering Paragraph 2 of the Order precluding suppliers from invoking or imposing accelerated payment, prepayment or other extraordinary payment terms and precluding unilateral termination by any supplier, and considering the general credit issues which have, in part, precipitated the California natural gas emergency, I conclude that the purpose and effect of the Order would be frustrated were J. Aron able to require a standby letter of credit or other collateral as a term of continuing the supply relationship mandated by the Order.

ORDER

Accordingly, pursuant to Ordering Paragraph 3 of the Order, and pursuant to section 302 of the Natural Gas Policy Act of 1978 and sections 101(a) and (c) of the Defense Production Act of 1950, it is hereby ordered that:

Under the terms of any contractual arrangements between J. Aron and PG&E subject to Ordering Paragraph 2 of the Order, J. Aron is required to supply natural gas to PG&E without a requirement for a standby letter of credit or other collateral.

Issued in Washington, D.C., on January 22, 2001.

BY DIRECTION OF THE SECRETARY OF ENERGY:

A handwritten signature in black ink, consisting of a large, stylized 'E' followed by a series of loops and a horizontal line extending to the right.

Eric J. Fygi
Acting General Counsel

Attachment

Pacific Gas and Electric Company
Department of Defense Mission Critical Functions JEOPARDIZED
By
Gas and Electric Delivery Curtailments

DOD Installation	Pacific Gas and Electric Company Delivery Services	JEOPARDIZED Mission Critical Functions	Does Base Have Backup Generation	Limitations on Backup Generation
Beal AFB	- Natural Gas - Electric Energy	- Major Missile Detection and Tracking of space objects. - High level intelligence function via High Altitude Reconnaissance (U-2s) and 1 of only 2 photo interpretation shops in the USAF. - Air Refueling Capability	- Yes.	- Air Quality. - Not enough for all load.
Travis AFB	- Natural Gas - Electric Energy	- Largest Air Mobility Wing in Mobility Command. Includes: - 60 th Air Mobility Wing - 615 th Air Mobility Operations Group - 615 th Air Mobility Squadron - Major Airlift and Air Refueling Capability for one half of the world, Mississippi to India. - 349 th Air Mobility Wing, largest Reserve Wing in the Air Force. - Naval TACOMA, a classified function. - Large Medical Center treating patients with worst conditions. - Mortuary Service for Pacific Area	- Yes.	- Air Quality. - Backup Generation is for Hospital load only.
Vandenberg AFB	- Electric Energy	- 14 th Air Force Command; Ensure space augments combat capabilities of air, land, sea and special forces globally	- Yes	- Air Quality - Not enough for all load.

Pacific Gas and Electric Company
Department of Defense Mission Critical Functions JEOPARDIZED
By

Gas and Electric Delivery Curtailments				
			<ul style="list-style-type: none"> - 30th Space Wing Command; Spacelift Satellites to Polar Orbit, Respond to Worldwide contingencies - 381st Training Group; Training for Space and Missile operators and Maintainers for Air Force. 	
Edwards AFB	- Natural Gas	<ul style="list-style-type: none"> - Flight Test Center and Air Force Research and Development. - F-22 Program. - B-2 Bomber Testing. - Auxiliary Landing site for Space Shuttle. - F-15/F-16, Osprey Flight Testing. 	Unknown	Unknown
Lemoore NAS	- Electric Energy	<ul style="list-style-type: none"> - West Coast Headquarters for USS Hornet flight crew. 	Unknown	Unknown
Naval Post Graduate School in Monterey	<ul style="list-style-type: none"> - Natural Gas - Electric Energy 	<ul style="list-style-type: none"> - Naval Postgraduate school FNMOC facility provides weather data to the armed forces worldwide 	-Yes	<ul style="list-style-type: none"> - Air Quality - Not enough for all load.
Defense Logistics Agency Supply Depots @ Tracy & Sharpe	<ul style="list-style-type: none"> - Natural Gas - Electric Energy 	<ul style="list-style-type: none"> - "Just in Time" Global Warehousing and Shipping of critical DOD supplies to Navy, Air Force, and Army 	- Yes	<ul style="list-style-type: none"> - Air Quality - Capability only to back up computer operations
National Aeronautical Research Lab (Rocket Ridge near Edwards AFB)	- Natural Gas	TOP SECRET	Unknown	Unknown

Pacific Gas and Electric Company
Department of Defense Mission Critical Functions JEOPARDIZED
By

Gas and Electric Delivery Curtailments			
TOP SECRET			
	- Natural Gas		Unknown
China Lake Naval Weapons Station			Unknown
Onozuka Air Force Station	- Natural Gas - Electric Energy	- Provides Communication and ground support to more than 100 DOD, NASA, and NATO Satellites. - Commands and controls Air Force Satellite Control Network. - Operates Missile Warning System Supports NASA Launches, including the Space Shuttle. - Continuous operation of Department of Defense Satellites. - Provides launch and on-orbit support to the space shuttle, ballistic missile tests, booster upper stages, and NATO Communication satellites. - Backup support to operational military satellite missions performed by Satellite Operations Center and Schriever AFB, Colorado.	- Yes. - Capacity, operational status unknown.
			- Air Quality. - Operation limits unknown.
NASA Dryden	- Natural Gas	- R&D Critical of Aircraft design	Unknown
NASA Ames Wind Tunnels	- Natural Gas - Electric Energy	- Missile and Satellite tracking. - Global Military Monitoring. - Operates Solar and Astrophysical Observation systems. - Military Air Traffic Control.	Unknown
Lockheed Martin (Defense Contractor)	- Natural Gas - Electric Energy	- Armed Forces Communications Systems work - Supports Air Traffic Control	Unknown



Department of Energy
Washington, DC 20585

January 23, 2001

Further Temporary Emergency Natural Gas Purchase and Sale Order

By Memorandum dated January 19, 2001, the President authorized and directed the Secretary of Energy to exercise authorities under the Natural Gas Policy Act of 1978, 15 U.S.C. 3361 through 3364, and the Defense Production Act of 1950, 50 U.S.C. App. 2061 *et seq.*, to assure the continued availability of natural gas for high-priority (including electric generation) uses in the central and northern regions of California. The President found and declared, pursuant to title III of the Natural Gas Policy Act of 1978 and section 607 of the Public Utility Regulatory Policies Act of 1978, 15 U.S.C. 717z, that a natural gas supply emergency exists in those regions. He further found that natural gas supplies within those regions of California are scarce, critical and essential within the meaning of the Defense Production Act of 1950, and that assuring natural gas supplies to those regions of California is necessary and appropriate to maximize domestic energy supplies and to promote the national defense. Based on the President's Memorandum and the authorities previously vested in the Secretary of Energy, a Temporary Emergency Natural Gas Purchase and Sale Order (the Order) was issued on January 19, 2001, effective through 3:00 a.m., EST, January 24, 2001.

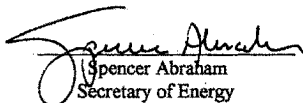
The circumstances that led to the issuance of the Order continue to exist. There remains a natural gas supply emergency that threatens the continued availability of natural gas for high-priority uses, including electric generation, in central and northern California. Therefore, I am extending the Order until February 7, 2001.

ORDER

Pursuant to section 302 of the Natural Gas Policy Act of 1978 and sections 101(a) and (c) of the Defense Production Act of 1950, it is hereby ordered that:

Ordering Paragraph 6 of the January 19, 2001, Temporary Emergency Natural Gas Purchase and Sale Order is amended by striking "January 24, 2001.", and inserting "February 7, 2001.", at the end thereof.

Issued in Washington, D.C., on January 23, 2001


Spencer Abraham
Secretary of Energy

DECLARATION

I, Kent M. Harvey, declare:

1. I am employed by Pacific Gas and Electric Company as Senior Vice President, Treasurer, and Chief Financial Officer. In that capacity, I am responsible for the procurement of natural gas for PG&E's core (residential and other high priority) customers. I make this declaration in support of PG&E's request to President Clinton requesting that he exercise his emergency natural gas supply authority under the Natural Gas Policy Act of 1978 and the Defense Production Act of 1950. Except as otherwise stated, I have personal knowledge of the facts stated in this Declaration, and if called upon to testify to them would do so.
2. In this Declaration, I describe recent and ongoing credit problems that have put PG&E in imminent danger of being unable to procure sufficient gas supplies at commercially reasonable terms to meet the requirements of its core customers, as well as the consequences of a supply shortfall, including the fact that electricity supplies are directly threatened due to this gas supply emergency.
3. PG&E is a combination gas and electric utility serving a large region in northern and central California. PG&E's public utility service territory encompasses an area of 70,000 square miles with a total population of approximately 13 million people. PG&E provides service in all or portions of 48 out of 58 counties in California. PG&E procures natural gas on behalf of approximately 3.9 million residential and small commercial customer accounts. These are defined as "core" customers under California law and regulation. PG&E also delivers natural gas to "non-core" customers, which includes a number of gas-fired electric power plants.
4. PG&E currently is in a financial crisis due to out-of-control prices in wholesale electricity markets, and its current inability to recover these costs from its retail customers. Directly as a consequence of this financial crisis, PG&E is currently at its minimum level of cash resources necessary to support essential electric and gas utility service to its customers. PG&E currently is unable to borrow more money to meet any of these obligations, and is foreclosed from the capital markets because of its financial condition.

5. It is well-documented that California currently is experiencing a severe shortage of electric power. The Secretary of Energy has issued a series of emergency orders, most recently on Thursday, January 11, in an effort to help stabilize the electric system by ensuring adequate supplies. Nevertheless, even with the Secretary's emergency order yesterday, on this date, January 12, 2001, the California Independent System Operator has declared a "Stage 2 Emergency Notice" due to the fact that operating reserves in the state are expected to fall below five percent.
6. Because of increasing difficulty in obtaining gas supplies for core customers, PG&E is on the verge of diverting gas supplies from non-core customers, including gas-fired power plants. Depending on weather conditions, and the actions of gas suppliers, I believe it is reasonably likely that gas supplies available for power plants, and for other non-core uses, will be reduced within the next few days. I explain this in the paragraphs that follow.
7. With few exceptions, the gas-fired electric generating plants located in northern and central California currently do not have the ability to switch to alternative fuel sources. Therefore, any curtailment in gas deliveries will lead to an immediate and possibly precipitous decline in the availability of electric power in California, which already is in seriously short supply as described in paragraph 5, above.
8. As described more fully below, our current gas supply situation is such that, if the average air temperature in our service area should drop by one degree Fahrenheit below the level currently predicted, or if a combination of windy conditions and cold temperatures should occur, or if as few as one additional gas supplier terminates deliveries to PG&E, depending on the size of such deliveries, then PG&E will need to begin to reduce gas deliveries to power plants in northern and central California. The most likely day on which this would first occur is Tuesday, January 16, the day after the Martin Luther King, Jr., holiday on Monday, January 15.

9. Most of PG&E's major natural gas suppliers have refused to sell additional gas supplies beyond their current commitments. These commitments are not sufficient to meet our projected February demand of approximately 1.3 billion cubic feet per day, or our March demands, and we also face even more severe shortfalls in supply in the months of April and beyond. In addition, as discussed below, the supplies available in January may not be sufficient if suppliers stop selling gas to PG&E under existing contracts, as some have threatened. One supplier, J. Aron & Company, whose volumes account for approximately 14 percent of the flowing supply used to serve our core customers this month, already has terminated service as of January 9. Another supplier, Western Gas Resources, is suspending gas deliveries effective January 13. Duke Energy (through two different affiliates) has requested additional credit assurances and has represented that Duke may suspend deliveries effective January 19. In addition, Sempra Energy and Coastal Merchant Energy both have requested additional credit assurances. I am concerned that, if such assurances are not provided, Sempra and Coastal also will suspend deliveries. In total, the volumes represented by the above-named companies constitute approximately 37 percent of PG&E's January flowing supply for core customers.
10. In addition to the suppliers who have already either terminated or given notice of termination of their gas supplies, other major gas suppliers previously informed us that they would take steps to suspend deliveries of gas to PG&E under existing contractual arrangements if PG&E would not provide, or in some instances agree to continue to provide, what the suppliers deem to be an assurance of payment, such as pre-payment for the gas supplies. Initially, PG&E agreed to prepayment arrangements with some suppliers. But, as more suppliers began demanding such terms, we had no choice but to inform all of the suppliers that we could no longer make advance payments to any supplier.
11. PG&E intends to pay its gas suppliers and pipeline service providers in full in the ordinary course of business. The gas crisis PG&E is facing today is a result of demands by suppliers and pipelines for out-of-the-ordinary credit assurances and pre-payments that threaten PG&E's liquidity and its continued ability to provide gas service to core customers.

12. With the supply terminations we already have suffered or will suffer under the notices we have received, our ability to serve core needs, and avoid curtailment of power plant deliveries, is gravely compromised. If a sufficient number of gas suppliers refuse to flow their committed gas, or if the gas pipeline service providers were to suspend service to PG&E, then PG&E's ability to supply natural gas to its core customers will be immediately and severely constrained. In response to the supply cuts by the one supplier that have been made to date, PG&E already has been compelled to over-draw gas from storage in order to make up the lost volumes. If PG&E's service territory were to experience a cold snap under such circumstances, or if the cut volumes were to increase or cause storage to be drawn down prematurely, then core customers would experience shortages. This, in turn, would require diversions of gas supplies away from non-core customers, including gas-fired electric generators, under PG&E's existing state-approved gas tariff.
13. In the event of a gas shortage affecting core customers, PG&E is authorized by its gas tariff to divert the gas of non-core customers, on behalf of its core customers, and PG&E is required pay a penalty payment totaling \$100 per decatherm. Part of this penalty (\$50 per decatherm) is paid to the non-core customer whose gas is diverted. However, I would expect that the affected non-core customers (including gas-fired generators), or their gas suppliers, would simply halt deliveries of gas into PG&E's service territory and shut down their gas-fired operations, in order to avoid the credit exposure to PG&E that the penalty payment creates for them. Therefore, if diversions were to occur, I expect that the non-core supplies available for such diversions would simply disappear within a matter of two to three days.
14. Approximately two-thirds of the divertible gas on PG&E's gas system currently is consumed by electric generators. Therefore, any diversions of non-core gas under the provisions of PG&E's gas tariff will decrease the level of electric generation in PG&E's service territory and lead to a deepening of the supply crisis on the electric system. For this reason, the diversions of non-core gas supplies to provide gas to core customers in the end will only aggravate the electric supply crisis.

15. PG&E is meeting with gas suppliers in an effort to arrive at satisfactory payment arrangements for the continued delivery of gas supplies under existing purchase contracts. In addition, PG&E concurrently is seeking emergency assistance from a neighboring gas utility under the jurisdiction of the California Public Utilities Commission, which may allow temporary, emergency deliveries of gas to PG&E. But these actions will not be sufficient, in my view, to compensate for the fact that PG&E has not been able to contract for adequate future gas supplies, commencing in February 2001, and I am concerned that the steps we have taken also may not be sufficient to remedy the immediate cessation of gas deliveries that some suppliers have threatened this month.
16. If the situation gets worse, then PG&E will have to apply extraordinary operating measures to its gas system in order to maintain sufficient pressure and prevent a total collapse. Entire counties could lose gas service and would not have service reinstated until the gas system could be repressurized. Repressurization would require the acquisition of significant volumes of gas, which would not be possible until PG&E's credit was restored or other equivalent arrangements were made. Gas outages also would require PG&E to go house-to-house in its service territory of over 3 million gas customers in order to re-light appliance pilot lights for affected customers, and could present serious safety issues if not handled with proper care and a substantial allocation of resources.
17. For these reasons, it is essential to the public health and safety of PG&E's residential and high-priority retail natural gas customers that emergency Federal and state authority be exercised, to mandate that natural gas suppliers continue to provide gas supplies to PG&E's Core Procurement Department at standard, monthly market prices (not daily spot prices), and at standard tariff rates for pipeline services, and without requiring pre-payment or other forms of credit assurance, during the current energy crisis in California. It is also essential that gas suppliers be required to continue selling supplies to PG&E at the levels in effect under contracts for the month of January, 2001, since we currently are unable to get adequate supplies contracted for the future, as described in paragraph 9, above.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Dated: 12 January 2001


Kent M. Harvey



GOVERNOR GRAY DAVIS

January 13, 2001

The Honorable William J. Clinton,
President of the United States
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

I have received and reviewed the request and supporting materials provided to you by Pacific Gas and Electric Company regarding an imminent gas supply shortage in northern and central California. I have consulted with my Public Utilities Commission and with other agencies of the State to verify that these public agencies agree that the impact to gas supplies in the State is immediate and severe. Based upon my review of all available information, I find that there is an imminent impact to public welfare based on the prospect of natural gas interruptions, including the exacerbating effect such interruptions would have on California's electricity grid.

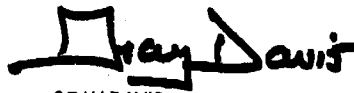
The State is using the authority available to my office and of all the State's agencies to address this problem to the greatest extent it can do so. It appears that action by the State alone cannot alleviate the immediate concern. Therefore, pursuant to the Natural Gas Policy Act of 1978, I hereby notify you that I have made the following findings, based on my review of the facts:

- There is an imminent likelihood that natural gas supplies to end-users in northern and central California will be interrupted.
- This imminent gas shortage endangers the supply of natural gas both for PG&E's residential and business customers and also for service to electric generating plants in northern and central California.
- If gas deliveries to electric power plants are curtailed, the effect would be to exacerbate the reliability of electric power supplies in California.

- Because of the gas supply concerns, and in the absence of emergency federal action, curtailments of gas deliveries to power plants are reasonably likely to occur within the next few days.
- Although I intend to initiate all remedies available to me as Governor of California and to the State Government in addressing this gas supply challenge, our ability to address the problem is limited by virtue of the fact that California is dependent for most of its gas supplies on supply sources located outside of California.
- For these reasons, your assistance, and the assistance of the Secretary of Energy, is urgently needed, to the full extent permitted by federal law, in order to help address this situation.

I appreciate your prompt consideration of this request.

Sincerely,

A handwritten signature in black ink that reads "Gray Davis". The signature is stylized, with a large, bold "G" and "D".

GRAY DAVIS
Governor

December 15, 2000

Rating Agency Positions

In conversations with the rating agencies over the last week, it is clear that their sense of concern has escalated to where their patience to see what solutions emerge from the regulatory and political process has been exhausted. They have all said that they will take significant action if there is not a concrete, workable proposal that will be credibly implemented over a short period of time.

They all want to see a credible plan now that

- Raises rates sufficiently to cover current costs and amortize past costs
- Insures regulatory recovery of deferred energy costs over a reasonable period of time
- Credibly addresses how to get current high wholesale costs under control before it cumulates to a point where it is too high to finance under commercial terms

Standard and Poor's

Richard Cortright (212) 438-7665

This week Cortright's analyst told us that the December 21 CPUC meeting is going to be the "seminal event" to them because (a) of the current size of the energy shortfall that must be paid, (b) the CPUC has either done nothing constructive in the past or indicated that they would do so and then, at best, did nothing and (c) the announcement by Davis/DOE did not address the uncollected balance issue. Further "lip service" will be viewed very negatively. They are looking for something very concrete. The key things they are looking for are recovery of regulatory assets and sufficient rate increases going forward. They have previously said that one thing that could trigger an earlier negative response was action by officials which indicated that an adequate solution was not forthcoming. The FERC decision may be such a trigger.

On December 11, S&P wrote "In the absence of timely state-directed or federal relief, the resulting debt burden and dearth of liquidity would not support the current debt ratings."

On December 18, S&P said that time has run out and it is a question of the magnitude of the downgrade not if there will be a downgrade.

Moody's

AJ Sabatelle (212) 553-4136

AJ said that any more "dithering" like what was done in connection with the Assigned Commissioners Ruling pre-hearing conference on October 27 would trigger a downgrade. In that hearing, the ALJ ignored the utilities' pleas to deal with the cash flow issues and instead entertained TURN's accounting proposal which had no short term cash flow benefit and threatened to prolong the rate freeze and the utilities' cash flow deficit. Sabatelle also set the December 21 CPUC meeting as the last chance for substantive action before Moody's would feel forced to take ratings action.

Fitch

Lori Woodland (312) 606-2309

Fitch has been the most blunt. Before we persuaded them to moderate their language, Fitch was going to say:

"Fitch views the liquidity pressure at California's two largest utilities ... as dire. Unless substantive actions are taken at the federal or state regulatory or legislative level, Fitch will consider significant ratings downgrades for the utilities including suspending short term ratings and lowering their long term rating below investment grade."

Departments of Energy and Commerce Action on Requests for Priority Rating Authority Under
Defense Production Act Section 101(c) Pursuant to Department of Energy Regulations at 10
CFR Part 216 (attached)

- | | | |
|----|----------|---|
| 1. | 11/17/78 | Northwest Alaskan Pipeline Co requests priority rating authority to purchase computer equipment |
| | 4/11/79 | Denied |
| 2. | 2/27/80 | Ingersoll Rand requests priority rating authority for purchase orders for gas compressor units for oil and gas production in Bay of Campeche, Gulf of Mexico |
| | 2/28/80 | Denied by DOE |
| 3. | 12/8/89 | ARCO Alaska requests, on behalf of prime contractor Parsons Co, priority rating authority for orders for relief valves from Anderson-Greenwood for Gas Handling Expansion Project (GHX) at Prudoe Bay oil field |
| | 12/18/89 | Granted |
| 4. | 12/8/89 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Blair Martin Co for equipment for GHX |
| | 12/15/89 | Granted |
| 5. | 12/14/89 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Valtek Inc for control valves for GHX |
| | 12/26/89 | Granted |
| 6. | 12/26/89 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Technical Products & Controls for hydraulic valve actuator for GHX |
| | 1/4/90 | Granted |
| 7. | 12/26/89 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Shafer Valve for equipment for GHX |
| | 1/4/90 | Granted |

- | | | |
|-----|----------|--|
| 8. | 12/26/89 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Union Pump Co for cooling medium circulation pumps for GHX |
| | 1/4/90 | Granted |
| 9. | 2/15/90 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on purchase order to General Electric (GE) for turbine equipment for GHX |
| | 2/21/90 | Granted |
| 10. | 2/15/90 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Philadelphia Gear Co for gear set blanks for GHX |
| | 2/22/90 | Granted |
| 11. | 2/22/90 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to GE for turbine equipment for GHX |
| | 3/26/90 | Granted |
| 12. | 8/27/90 | Department of Energy Office of Strategic Petroleum Reserve requests priority rating authority for orders for emergency parts needed for crude oil drawdowns during Persian Gulf War |
| | 9/6/90 | Granted |
| 13. | 12/18/90 | ARCO Alaska requests priority rating authority on orders to GE for equipment for GHX at two sites |
| | 3/19/91 | Denied by Commerce, no delivery problem at 1 site |
| | 4/24/91 | Granted for 2 nd site |
| 14. | 1/22/91 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to GE for gas lift turbine compressors for the Kuparuk Production Center Project on Alaskan North Slope |
| | 3/6/91 | withdrawn - GE will ship timely |

- | | | |
|-----|---------|--|
| 15. | 2/25/91 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to GE for turbine compressor trains for GHX |
| | 4/26/91 | Granted |
| 16. | 7/19/91 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Beaird Industries for two Triethylene Glycol Contactor Towers for GHX |
| | 8/29/91 | Granted |
| 17. | 2/14/92 | GE requests for special priority assistance to ensure Howmet Corp delivers gas turbine equipment on timely basis |
| | 2/21/92 | Withdrawn; Howmet agrees to make deliveries as per schedule. |
| 18. | 3/26/92 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Peerless Mfg Co for pressure vessels for GHX |
| | 4/14/92 | Granted |
| 19. | 3/26/92 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Custom Vessel Co for high pressure flare gas knock-out drums for GHX |
| | 4/14/92 | Denied by Commerce |
| 20. | 3/26/92 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on purchase order to Peerless Manufacturing Co for pressure vessels for GHX |
| | 4/14/92 | Granted |
| 21. | 7/23/92 | ARCO Alaska requests, on behalf of Parsons Co, priority rating authority on Parsons purchase order to Custom Vessel CO for reboiled low temperature separator column for GHX |
| | 8/18/92 | Granted |

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oil supply arrangements or reports related thereto. Such material shall be provided pursuant to the conditions prescribed by the Administrator at the time of such order or subsequently. As used in this section, the term "agreement" includes proposed or draft agreements, and agreements in which the parties have tentatively concurred but have not yet signed, between or among persons and a host country.

§215.5 Pricing and volume reports.

To the extent not reported pursuant to §215.3, any person lifting for export crude oil from a country shall report to the DOE within 30 days of the date on which he receives actual notice:

(a) Any change (including changes in the timing of collection) by the host government in official selling prices, royalties, host government taxes, service fees, quality or port differentials, or any other payments made directly or indirectly for crude oil; changes in participation ratios; changes in concessionary arrangements; and

(b) Any changes in restrictions on lifting, production, or disposition.

§215.6 Notice of negotiations.

Any person conducting negotiations with a host government which may reasonably lead to the establishment of any supply arrangement subject to reporting pursuant to §215.3(a), or may reasonably have a significant effect on the terms and conditions of an arrangement subject to §215.3(a), shall notify DOE of such negotiations. Such notice shall be made no later than the later of 30 days after the effective date of this regulation or within 14 days after such negotiations meet the conditions of this section, and shall specify all persons involved and the host government affected. Notice must be in writing to the Assistant Administrator for International Energy Affairs. Where this notice pertains to negotiations to modify a supply agreement previously reported to the Department of Energy under this part, such notice shall include the agreement serial number assigned to the basic agreement.

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PART 216—MATERIALS ALLOCATION AND PRIORITY PERFORMANCE UNDER CONTRACTS OR ORDERS TO MAXIMIZE DOMESTIC ENERGY SUPPLIES

Sec.

216.1 Introduction.

216.2 Definitions.

216.3 Requests for assistance.

216.4 Evaluation by DOE of applications.

216.5 Notification of findings.

216.6 Petition for reconsideration.

216.7 Conflict in priority orders.

216.8 Communications.

216.9 Violations.

AUTHORITY: Section 104 of the Energy Policy and Conservation Act (EPCA) Pub. L. 94-163, 89 Stat. 871; and section 101(c) of the Defense Production Act of 1950 (DPA) (50 U.S.C. App. 2071(c)), as amended; section 7, E.O. 11812, April 13, 1976; Defense Mobilization Order No. 13, Sept. 22, 1976; 44 CFR Part 330; Defense Priorities and Allocations System Delegation No. 2, 49 FR 30430.

SOURCE: 43 FR 5212, Feb. 14, 1978, unless otherwise noted.

§216.1 Introduction.

(a) This part describes and establishes the procedures to be used by the Department of Energy ("DOE") in considering and making certain findings required by section 101(c)(3) of the Defense Production Act of 1950, as amended, 50 U.S.C. App. 2071(c)(3) ("DPA"). Section 101(c) authorizes the allocation of, or priority performance under contracts or orders (other than contracts of employment) relating to, supplies of materials and equipment in order to maximize domestic energy supplies if the findings described in section 101(c)(3) are made. Among these findings are that such supplies of materials and equipment are critical and essential to maintain or further exploration, production, refining, transportation or the conservation of energy supplies or for the construction and maintenance of energy facilities. The function of finding if such supplies are critical and essential was delegated to the Administrator of the Department of Energy ("DOE") pursuant to Executive Order

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11912 of April 13, 1976, Defense Mobilization Order ("DMO") No. 13 dated September 22, 1976, 41 FR 43720, and Department of Commerce, Bureau of Domestic Commerce, Delegation No. 4, effective date December 1, 1976, 41 FR 52331. Delegation No. 4 was superseded by Defense Priorities and Allocations System Delegation No. 2, effective date August 29, 1984, 49 FR 30430. On October 1, 1977, pursuant to section 301(a) of the Department of Energy Organization Act (Pub. L. 95-91), all of the functions of DOE and all of the functions of the DOE Administrator were transferred to the Secretary of Energy.

(b) The purpose of these regulations is to establish the procedures and the criteria to be used by DOE in determining whether programs or projects maximize domestic energy supplies and finding whether or not supplies of material and equipment are critical and essential, as required by DPA section 101(c)(3). The critical and essential finding will be made only for supplies of materials and equipment related to those programs or projects determined by DOE to maximize domestic energy supplies. These regulations do not require or imply that the findings, on which the exercise of such authority is conditioned, will be made in any particular case.

(c) If DOE determines that a program or project maximizes domestic energy supplies and finds that supplies of materials and equipment are critical and essential to maintain or further the exploration, production, refining, transportation or conservation of energy supplies or for the construction and maintenance of energy facilities, such determination and finding will be communicated to the Department of Commerce. If not, the applicant will be so informed. If the determination and finding described above are made, the Department of Commerce, pursuant to DPA section 101(c), Executive Order 11912 and DMO No. 13, will find whether or not (1) the supplies of materials and equipment in question are scarce and (2) maintenance or furtherance of exploration, production, refining, transportation, or conservation of energy supplies or the construction and maintenance of energy facilities cannot be reasonably accomplished without exer-

cising the authority specified in section 101(c). If these additional two findings are made, the Department of Commerce will notify DOE, and DOE will inform the applicant that it has been granted the right to use priority ratings under the Defense Priorities and Allocations System ("DPAS") regulation established by the Department of Commerce, 15 CFR 350.

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8311, Mar. 11, 1986]

§216.2 Definitions.

As used in these regulations:

(a) *Secretary* means the Secretary of the Department of Energy.

(b) *Applicant* means a person requesting priorities or allocation assistance in connection with an energy program or project.

(c) *Application* means the written request of an applicant for assistance.

(d) *Assistance* means use of the authority vested in the President by DPA section 101(c) to implement priorities and allocation support.

(e) *DOC* means the Department of Commerce, acting through the Secretary or the delegate of the Secretary.

(f) *DOE* means the Department of Energy, acting through the Secretary or the delegate of the Secretary.

(g) *Eligible energy program or project* means a designated activity which maximizes domestic energy supplies by furthering the domestic exploration, production, refining, transportation or conservation of energy supplies or construction and maintenance of energy facilities within the meaning of DPA section 101(c), as determined by DOE.

(h) *FEMA* means the Federal Emergency Management Agency.

(i) *Materials and equipment* means any raw, in-process, or manufactured commodity, equipment, component, accessory, part, assembly or product of any kind.

(j) *Person* means an individual, corporation, partnership, association, or any other organized group of persons (or legal successor or representative thereof), and includes the United States or any other government and any political subdivisions (or any agency) thereof.

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8311, Mar. 11, 1986]

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§216.3 Requests for assistance.

(a) Persons who believe that they perform work associated with a program or project which may qualify as an eligible energy program or project and wishing to receive assistance as authorized by DPA section 101(c)(1) may submit an application to DOE requesting DOE to determine whether a program or project maximizes domestic energy supplies and to find whether or not specific supplies of materials or equipment identified in the application are critical and essential for a purpose identified in section 101(c). The application should be sent to: Department of Energy, Procurement and Assistance Management Directorate, Attn: MA-422, Forrestal Building, 1000 Independence Avenue SW., Washington, DC 20585. The application shall contain the following information:

(1) The name and address of the applicant and of its duly authorized representative.

(2) A description of the energy program or project for which assistance is requested and an assessment of its impact on the maximization of domestic energy supplies.

(3) The amount of energy to be produced by the program or project which is directly affected by the supplies of the materials or equipment in question.

(4) A statement explaining why the materials or equipment for which assistance is requested are critical and essential to the construction or operation of the energy project or program.

(5) A detailed description of the specific supplies of materials and equipment in connection with which assistance is requested, including: Components, performance data (capacity, life duration, etc.), standards, acceptable tolerances in dimensions and specifications, current inventory, present and expected rates of use, anticipated deliveries and substitution possibilities (feasibility of using other materials or equipment).

(6) A detailed description of the sources of supply, including: Name of the regular supplying company or companies, other companies capable of supplying the materials and equipment, location of supplying plants or plants capable of supplying the needed mate-

rials and equipment, possible suppliers for identical or substitutable materials and equipment and possible foreign sources of supply.

(7) A detailed description of the delivery situation, including: Normal delivery times, promised delivery time without priorities assistance, and delivery time required for expeditious fulfillment or completion of the program or project.

(8) Evidence of the applicant's unsuccessful efforts to obtain on a timely basis the materials and equipment in question through normal business channels from current or other known suppliers.

(9) A detailed estimate of the delay in fulfilling or completing the energy program or project which will be caused by inability to obtain the specified materials and equipment in the usual course of business.

(10) Any known conflicts with rated or authorized controlled material orders already issued pursuant to the DPA for supplies of the described materials and equipment.

(11) Quarterly estimates of requirements for controlled materials, if applicable, by shapes and forms as prescribed by the DPAS regulation, §350.31(e)(2).

(b) DOE, on consultation with the DOC, may prescribe standard forms of application or letters of instruction for use by all persons seeking assistance.

(c) In addition to the information described above, DOE may from time to time request whatever additional information it reasonably believes is relevant to the discharge of its functions pursuant to DPA section 101(c).

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8311, Mar. 11, 1986]

§216.4 Evaluation by DOE of applications.

(a) Based on the information provided by the applicant and other available information, DOE will assess the application and (1) determine whether or not the energy program or project in connection with which the application is made maximizes domestic energy supplies and should be designated an eligible energy program or project and (2) find whether the described supplies of materials and equipment are critical

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and essential to the eligible energy program or project.

(b) In determining whether the program or project referred to in the application should be designated an eligible energy program or project, DOE will consider all factors which it considers relevant including, but not limited to, the following:

- (1) Quantity of energy involved;
- (2) Benefits of timely energy program furtherance or project completion;
- (3) Socioeconomic impact;
- (4) The need for the end product for which the materials and equipment are allegedly required; and
- (5) Established national energy policies.

(c) In findings whether the supplies of materials or equipment described in the application are critical and essential to an eligible energy program or project, DOE will consider all factors which it considers relevant including, but not limited to, the following:

- (1) Availability and utility of substitute materials or equipment; and
- (2) Impact of the nonavailability of the specific supplies of materials and equipment on the furtherance or timely completion of the approved energy program or project.

(d) Increased costs which may be associated with obtaining materials or equipment without assistance shall not be considered a valid reason for finding the materials and equipment to be critical and essential.

(e) After DOE has determined a program or project to be an eligible energy program or project, this determination shall be deemed made with regard to subsequent applications involving the same program or project unless and until DOE announces otherwise.

§216.5 Notification of findings.

(a) DOE will notify the DOC if it finds that supplies of materials and equipment, for which an applicant requested assistance, are critical and essential to an eligible energy program or project, and in such cases will forward to the DOC the application and whatever information or comments DOE believes appropriate. If DOE believes at any time that findings previously made may no longer be valid, it

will immediately notify the DOC and the affected applicant(s) and afford such applicant(s) an opportunity to show cause why such findings should not be withdrawn.

(b) If DOC notifies DOE that DOC has found that supplies of materials and equipment, for which the applicant requested assistance, are scarce and that the related eligible energy program or project cannot reasonably be accomplished without exercising the authority specified in DPA section 101(c)(1), DOE will notify the applicant that the applicant is authorized to place rated orders and/or authorized controlled material orders for specific supplies of materials and equipment pursuant to the provisions of the DPAS Regulation, as promulgated by the Department of Commerce.

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8312, Mar. 11, 1986]

§216.6 Petition for reconsideration.

If DOE, after evaluating an application in accordance with §216.4, does not determine that the energy program or project maximizes domestic energy supplies or does not find that the supplies of materials and equipment described in the application are critical and essential to an eligible energy program or project, it will so notify the applicant and the applicant may petition DOE for reconsideration. If DOE concludes at any time that findings previously made are no longer valid and should be withdrawn, DOE will so notify the affected applicant(s), and such applicant(s) may petition DOE for reconsideration of the withdrawal decision. Such a petition is deemed accepted when received by DOE at the address stated in §216.3. DOE will consider the petition for reconsideration and either grant or deny the relief requested. Written notice of the decision and of the reasons for the decision will be provided to the applicant. There has not been an exhaustion of administrative remedies until a petition for reconsideration has been submitted and the review procedure completed by grant or denial of the relief requested.

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The denial of relief requested in a petition for reconsideration is a final administrative decision.

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8312, Mar. 11, 1986]

§216.7 Conflict in priority orders.

If it appears that the use of assistance pursuant to DPA section 101(c) creates or threatens to create a conflict with priorities and allocation support provided in connection with the national defense pursuant to DPA section 101(a), DOE will work with the DOC and other claimant agencies affected by such conflict in an attempt to reschedule deliveries or otherwise accommodate such competing demands. If acceptable solutions cannot be agreed upon by the claimant agencies the FEMA will resolve such conflicts.

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8312, Mar. 11, 1986]

§216.8 Communications.

All written communications concerning these regulations shall be addressed to:

Department of Energy, Procurement and Assistance Management Directorate, Attn: MA-422, Forrestal Building, 1000 Independence Avenue, SW., Washington, DC 20585.

[43 FR 6212, Feb. 14, 1978, as amended at 51 FR 8312, Mar. 11, 1986]

§216.9 Violations.

Any person who willfully furnishes false information or conceals any material fact in the course of the application process or in a petition for reconsideration is guilty of a crime, and upon conviction may be punished by fine or imprisonment or both.

PART 218—STANDBY MANDATORY INTERNATIONAL OIL ALLOCATION

Subpart A—General Provisions

- Sec.
218.1 Purpose and scope.
218.2 Activation/Deactivation.
218.3 Definitions.

Subpart B—Supply Orders

- 218.10 Rule.
218.11 Supply orders.

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- 218.12 Pricing.

Subpart C [Reserved]

Subpart D—Procedures

- 218.30 Purpose and scope.
218.31 Incorporated procedures.
218.32 Review.
218.33 Stay.
218.34 Addresses.

Subpart E—Investigations, Violations, Sanctions and Judicial Actions

- 218.40 Investigations.
218.41 Violations.
218.42 Sanctions.
218.43 Injunctions.

AUTHORITY: 15 U.S.C. 751 *et seq.*; 15 U.S.C. 787 *et seq.*; 42 U.S.C. 6201 *et seq.*; 42 U.S.C. 7101 *et seq.*; E.O. 11790, 39 FR 23185; E.O. 12009, 42 FR 46267; 28 U.S.C. 2461 note.

SOURCE: 44 FR 27972, May 14, 1979, unless otherwise noted.

Subpart A—General Provisions

§218.1 Purpose and scope.

(a) This part implements section 251 of the Energy Policy and Conservation Act (Pub. L. 94-163) (42 U.S.C. 6271), as amended, which authorizes the President to take such action as he determines to be necessary for performance of the obligations of the United States under chapters III and IV of the Agreement on an International Energy Program (TIAS 8278), insofar as such obligations relate to the mandatory international allocation of oil by International Energy Program participating countries.

(b) *Applicability.* This part applies to any firm engaged in producing, transporting, refining, distributing or storing oil which is subject to the jurisdiction of the United States.

§218.2 Activation/Deactivation.

(a) This rule shall take effect providing:

- (1) The International Energy Program has been activated; and,
- (2) The President has transmitted this rule to Congress, has found putting such rule into effect is required in order to fulfill obligations of the United States under the International Energy Program and has transmitted such a finding to the Congress together



Department of Energy
Washington, DC 20585

Temporary Emergency Natural Gas Purchase and Sale Order

By Memorandum dated January 19, 2001, the President authorized and directed me to exercise authorities under the Natural Gas Policy Act of 1978, 15 U.S.C. 3361 through 3364, and the Defense Production Act of 1950, 50 U.S.C. App. 2061 *et seq.*, to assure the continued availability of natural gas to high-priority uses in the central and northern regions of California. The President found and declared, pursuant to title III of the Natural Gas Policy Act of 1978 and section 607 of the Public Utility Regulatory Policies Act of 1978, 15 U.S.C. 717z, that a natural gas supply emergency exists in those regions. He found that this emergency endangers continued supply of natural gas to high-priority uses, including the generation of electric power. He further found that natural gas supplies within those regions of California are scarce, critical and essential within the meaning of the Defense Production Act of 1950, and that assuring natural gas supplies to those regions of California is necessary and appropriate to maximize domestic energy supplies and to promote the national defense. A copy of the President's Memorandum to me is attached (Attachment A). Section 304 of the Natural Gas Policy Act, 15 U.S.C. 3364, and sections 705 and 706 of the Defense Production Act, 50 U.S.C. App. 2155 and 2166, may be relied on as appropriate to ensure compliance with this Order regarding the natural gas supply emergency in California. Based on the President's Memorandum and the authorities previously vested in the Secretary of Energy, I take the following actions:


ORDER

Pursuant to section 302 of the Natural Gas Policy Act of 1978 and sections 101(a) and (c) of the Defense Production Act of 1950, it is hereby ordered that:

1. Pacific Gas and Electric Company (PG&E) is authorized to make emergency purchases of natural gas from the suppliers listed on Attachment B to this Order to meet the high-priority uses on its system as that term is defined in title III of the Natural Gas Policy Act of 1978 and in the President's Memorandum.
2. The suppliers listed in Attachment B to this Order are directed to sell natural gas to PG&E under terms consistent with any contractual arrangements in existence between PG&E and the suppliers listed in Attachment B (including arrangements between PG&E and suppliers' affiliates) at any time within the past 30 days, but subject to the conditions that (a) no accelerated payment, prepayment or other extraordinary payment terms may be imposed or invoked by any supplier, and (b) no termination by any supplier shall be permitted during the term of this Order without the agreement of the parties or the approval of the Secretary.
3. If any supplier listed in Attachment B and PG&E fail to agree on the terms of their contractual arrangement for the purchase, sale, and delivery of natural gas under this Order, the Secretary will set the terms of such an arrangement.

4. Natural gas supplies purchased by PG&E pursuant to this Order may be used only for sale by PG&E for high-priority uses, including the generation of electric power, and cannot be sold by PG&E into the wholesale market.
5. Both PG&E and the suppliers listed in Attachment B shall report weekly to me the prices and volumes of any natural gas delivered, transported, or contracted for under this Order during the previous week.
6. This Order is effective immediately and expires at 3:00 a.m., EST, January 24, 2001.

Issued in Washington, D.C., on January 19, 2001.


Bill Richardson
Secretary of Energy

Attachments

ATTACHMENT A

THE WHITE HOUSE

WASHINGTON

January 19, 2001

MEMORANDUM FOR THE SECRETARY OF ENERGY

SUBJECT: Electric Energy Shortage in California

There is a current electric energy shortage in California that also threatens the continued availability of natural gas to consumers in the central and northern regions of California. Continuity of supply in those regions of California is dependent on the continued ability of the natural gas distributor in those regions to acquire and transport natural gas to all consumers throughout those regions.

Therefore I find and declare, pursuant to title III of the Natural Gas Policy Act of 1978 (15 U.S.C. 3361 through 3364) and section 607 of the Public Utility Regulatory Policies Act of 1978 (15 U.S.C. 717z), that a natural gas supply emergency exists in those regions, and that exercise of the emergency authorities there provided for is reasonably necessary to assist in meeting natural gas requirements for high priority uses. I find that this emergency endangers continued supply of natural gas for high priority uses, which I determine under the Natural Gas Policy Act to include use for generating electricity. I also find that natural gas supplies within those regions of California are scarce, critical, and essential within the meaning of the Defense Production Act of 1950 (50 U.S.C. App. 2061 et seq.), and that assuring maintenance of natural gas supplies to those regions of California cannot reasonably be accomplished without use of these authorities and is necessary and appropriate to maximize domestic energy supplies (including electricity) and to promote the national defense.

Accordingly, you are authorized and directed as follows:

1. To exercise all the authorities previously delegated to the Secretary of Energy, without consultation with or prior approval of any other officer, to act in accordance with the findings herein pursuant to title III of the Natural Gas Policy Act of 1978 and section 607 of the Public Utility Regulatory Policies Act of 1978;

2. To exercise as to continuity of supplies of natural gas to the central and northern regions of California all authorities under the Defense Production Act of 1950, in accordance with the findings of scarcity, essentiality, and criticality made herein, pursuant to Executive Order 11790, as continued in force by Executive Order 12919, without the prior approval of any other officer, notwithstanding any procedural provisions generally specified in regulations that ordinarily would govern the Secretary of Energy's invocation of the authorities under the Defense Production Act of 1950, including in particular those under section 101(c) thereof (50 U.S.C. App. 2071(c)).

You are authorized and directed to publish this memorandum in the Federal Register.

William G. Clinton

**Pacific Gas and Electric Company
Gas Procurement
NATURAL GAS SUPPLIERS**

ATTACHMENT B

Supplier Party	Address	City	State	Zip	Contract Name	Fax #
ADONIS ENERGY CORPORATION	6555 Hollister, #1220	HOUSTON	TX	77040	MIKE NEWSOME	713 460-9069
AEP ENERGY SERVICES, INC	5555 SAN FELIPE, SUITE 2000	HOUSTON	TX	77056	DAVE DUINN	814 324-4591
ALTRA TRANSACTION, L.L.C.	1221 LARMAR STREET, SUITE 950	HOUSTON	TX	77010	DAVID HANSON	713 844-7689
AVISTA CORPORATION	210 W. NORTH RIVER DRIVE, #810	SPOKANE	WA	98220-3727	ROBER GRUBER	509 465-8766
BP ENERGY COMPANY	P.O. BOX 3082, WIL3	HOUSTON	TX	77253-3082	JAMES TAYLOR	281 365-4932
CALPINE FUELS CORPORATION	6700 KOLL CENTER PARKWAY #200	PLEASANTON	CA	94566	BRAD BARNDIS	925 900-8925
COAST ENERGY GROUP, A DIV CORNERSTONE PROP.	1600 HIGHWAY 6, SUITE 400	SUGARLAND	TX	77478	BRICE DILLE	281 555-4200
COASTAL MERCHANT ENERGY, L.P.	FIVE GREENWAY PLAZA	HOUSTON	TX	77046-0502	DAVID ARLEDGE	713 877-7305
COOK INLET ENERGY SUPPLY, L.L.C.	10100 SANTA MONICA BLVD., SUITE 2550	LOS ANGELES	CA	90087	GREG CRAIG	310 557-1176
CORAL ENERGY RESOURCES L.P.	12 HOUSTON CENTER, 909 FANNIE ST., SUITE 700	HOUSTON	TX	77010	STEVE WIDNER	713 787-5455
DUKE ENERGY TRADING AND MKTG LLC	4 TRIAD CENTER, SUITE 1000	SALT LAKE CITY	UT	84180	SCOT ALLEN	801 331-5470
DYNEGY MARKETING & TRADE	1000 LOUISIANA, SUITE 5900	HOUSTON	TX	77002	CHUCK WATSON	713 307-6888
EL PASO MERCHANT ENERGY - GAS, L.P.	P.O. Box 2511	HOUSTON	TX	77252-2511	WILLIAM WISE	713 420-6030
ENRON NORTH AMERICA CORP.	P.O. Box 4428	HOUSTON	TX	77252-4428	JEFF SKILLING	713 646-8381
KEYSPAN ENERGY	100 EAST OLD COUNTRY ROAD	HICKSVILLE	NY	11801	CHARLES A. DAVERIO	516 545-5467
JCC ENERGY CORPORATION	302 N. MARKET ST., SUITE 500	DALLAS	TX	75202-1846	KARL BUTLER	214 744-2206
J. ARON & COMPANY	85 BROAD STREET, 5TH FLOOR	NEW YORK	NY	10004	HENRY PAULSON	212 592-0633
ONEOK ENERGY MKTG. & TRADING CO., L.P.	P.O. BOX 2485	TULSA	OK	74102-2405	PATRICK McDOWIE	918 585-9254
PG&E ENERGY TRADING CORPORATION	1100 LOUISIANA, SUITE 1000	HOUSTON	TX	77002	SARA BARPOULIS	301 280-6375
RELIANT ENERGY SERVICES, INC.	P.O. BOX 4455	HOUSTON	TX	77210-4455	STEVE LEDBETTER	713 207-3169
SEMPRA ENERGY TRADING CORP.	58 COMMERCE	STAMFORD	CT	06902	DON FELSINGER	619 698-4611
SOUTHERN COMPANY ENERGY MARKETING L.P.	1155 Piedmont Center West, Suite 130	ATLANTA	GA	30338-5416	A. WILLIAM DAHLBERG	404 506-0455
TEXACO NATURAL GAS	1111 BAGDY ST.	HOUSTON	TX	77002-0200	GARY UNDERWOOD	713 752-7841
TXU ENERGY TRADING COMPANY	1717 MAIN STREET, SUITE 2000	DALLAS	TX	75201	EARL NYE	215 812-7077
WESTERN GAS RESOURCES, INC.	12200 NORTH PECOS STREET	DENVER	CO	80234-3439	BRIAN JEFFRIES	303 457-9748
WILD GOOSE STORAGE INC.	2780 WEST LIBERTY RD.	GRIDLEY	CA	95948	RICK DANIEL	403 265-8180
WILLIAMS ENERGY MKTG & TRADING CO.	ONE WILLIAMS CENTER, 19TH FL., DEPT. 558	TULSA	OK	74172	KEITH BAILEY	918 573-3905

STATE OF CALIFORNIA
ELECTRICITY OVERSIGHT BOARD



Gray Davis, Governor

January 17, 2001

Mr. Richard Glick
Senior Policy Advisor to the Secretary
U.S. Department of Energy
1000 Independence Avenue, SW
Washington, DC 20585

Via facsimile and electronic mail

Dear Mr. Glick:

This responds to three questions from DOE staff you identified in our conversation last evening in relation to the use of federal authority to prevent catastrophic curtailment of natural gas deliveries to California. These questions were: (1) can the government of California confirm that suspension of wholesale gas deliveries have occurred or been threatened in Southern California as well as in Northern California; (2) is it possible for the State to backstop gas purchases by PG&E by pledging its full faith and credit as a guarantor behind PG&E gas purchases; (3) could a State agency commence making wholesale purchases of gas and reselling it to PG&E.

1. The Electricity Oversight Board has been informed by the Independent Energy Producers Association and the California Cogeneration Counsel that member generators of each organization located in the service territory of Southern California Edison Company have been informed by one or more gas suppliers that delivery of gas under normal terms will be suspended as of January 18th or 19th. I am informed that one supplier, Coastal, has indicated that deliveries may continue contingent on full payment in advance.
2. There is no practical way for the State to offer its creditworthiness as a guarantee behind purchases of gas by PG&E or any similar entity. Article 16, Section 6 of the California Constitution provides, in pertinent part, that the State "shall have no power to give or lend, or to authorize the giving or lending, of the credit of the State ... in aid of any person, association, or corporation ... or to pledge the credit thereof, in any manner whatever, for the payment of the liabilities of any individual, association, ... whatever ...". This provision broadly and generally prevents the State from pledging its credit behind any private purchaser. Analysis in relation to the current situation concludes there is no mechanism whereby the State can act as a guarantor.
3. Recognizing that the California Department of Water Resources (CDWR) has been able to make some electricity purchases for redelivery, DOE staff has asked whether there is a

State agency that could perform a similar function with natural gas. The answer, unfortunately, is no. The CDWR has existing authority to engage in trades, including reselling, of bulk electricity. There is no State agency that has analogous authority to engage in trading of natural gas. Article 3, Section 3.5 prevents altering the authority of an agency by an emergency enactment. Consequently, even using a special urgent session of the Legislature, that soonest that any agency could be given the necessary authority is 90 days after the close of a special legislative session for that purpose.

I hope these responses fully answer the questions you posed. If you have any further concerns or require anything more in relation to this subject please contact me promptly.

Thank you for your assistance in this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "E. Saltmarsh", written over a horizontal line.

Erik N. Saltmarsh
Chief Counsel

 **Pacific Gas and
Electric Company**
January 12, 2001

Gordon R. Smith
President and
Chief Executive Officer

77 Beale Street
San Francisco, CA 94105
Mailing Address
Mail Code 632
P.O. Box 770000
San Francisco, CA 94177
415.973.2166

The Honorable William J. Clinton,
President of the United States
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Re: Request For Declaration of Natural Gas Supply Emergency for Northern and
Central California

Dear Mr. President:

Pacific Gas and Electric Company respectfully requests, under the authority granted to you by the Natural Gas Policy Act of 1978 (15 U.S.C. sections 3361 -3364), and the Defense Production Act of 1950 (50 U.S.C. Appendix § 2071), that you declare a natural gas supply emergency for northern and central California. As provided in these statutes, such an Emergency Declaration is necessary because Pacific Gas and Electric Company faces an imminent, severe shortage of natural gas supplies for high-priority end-use customers, and your assistance is urgently needed to help remedy this crisis by ensuring that adequate supplies are made available by PG&E's gas suppliers.

Pacific Gas and Electric Company is the local gas distribution company that delivers gas in northern and central California to those defined in the Natural Gas Policy Act (NGPA) as high priority users – including approximately 3.9 million residential customers who use natural gas for home heating and other essential home uses.

Your Emergency Declaration will permit the Secretary of Energy, under Executive Order No. 12235 and under the Defense Production Act, to require gas suppliers to continue to contract with and to provide natural gas to PG&E for distribution to our high priority users during these winter months. This is the essential remedy PG&E is requesting on behalf of its high-priority gas and electric customers.

Pacific Gas and Electric Company is very concerned that, unless you and the Secretary act immediately under the NGPA and the Defense Production Act, in accordance with this request, the current energy crisis in California and the western United States will lead to curtailments (gas outages) to high priority users *in the next few days and weeks and*

through the remainder of this winter, directly threatening the health and safety of millions of Californians.

Because natural gas is a primary fuel for electric generation in California, and because the gas-fired generators in PG&E's service territory generally have no ability as a practical matter to switch to alternative fuels, the imminent disruptions in gas supplies also will worsen the problem of inadequate supplies of electric power, and could lead to widespread power outages. Hence, if not contained, this gas supply crisis also will lead to a significant worsening of the electricity crisis in California.

PG&E is in the midst of a financial crisis as a consequence of the out-of-control prices in wholesale electricity markets and an inability to pass these costs onto its retail electric customers. At the same time, gas suppliers have (1) made demands that PG&E provide prepayment or other forms of payment assurance for gas supplies, which PG&E is unable to meet; (2) refused to sell gas to PG&E for future periods commencing as early as February 1, 2001; and (3) threatened to terminate (and in some instances already have terminated) gas supplies during the month of January.

If our suppliers refuse to sell and deliver gas to Pacific Gas and Electric Company, then the only supplies available to the Company will be gas currently held in storage, possibly some gas provided by neighboring utilities on an emergency, short-term basis, and to a limited extent gas confiscated on an emergency basis from industrial customers -- including in-state, gas-fired electric generators. Without the gas supplies currently under contract, gas available to serve high priority customers will be depleted in a very short time, especially if temperatures fall below normal. There is an imminent danger that, in the very near future, home gas furnaces, stoves and water heaters will go off throughout northern and central California for lack of adequate gas supplies. A more immediate concern is that PG&E may be required to curtail gas deliveries to gas-fired electric power plants within the next few days, which would worsen the crisis we already face in obtaining adequate supplies of electric power.

For these reasons, I request that you immediately invoke your emergency authority under the Natural Gas Policy Act of 1978 (Pub.L.95-621, Title III, sections 301-304), and the Defense Production Act of 1950 (50 U.S.C. Appendix § 2071), to require PG&E's gas suppliers to sell gas to PG&E at standard, monthly market prices, and without requiring prepayment or other unusual payment arrangements. PG&E requests that this emergency order remain in place for the period from January 11, 2001, until April 13, 2001.

Further, because a large percentage of the gas supplies used to serve PG&E's core customers originate in producing fields in western Canada, we ask that you immediately contact Canadian Prime Minister Chrétien, and request that he seek the cooperation of

federal and provincial government officials in Canada to provide all reasonable assistance in ensuring that Canadian gas producers, suppliers and pipeline companies continue to supply gas to PG&E on the terms described herein, during the current gas crisis.

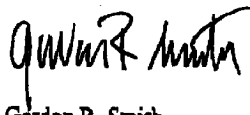
The foregoing steps are essential in order to ensure that gas suppliers continue to provide Pacific Gas and Electric Company with gas supplies at standard, monthly market prices (not daily spot prices), and with standard payment arrangements (not prepayment) for high priority users during this crisis. We believe this remedy also is entirely fair and balanced, since it merely will require suppliers to continue to honor existing purchase-and-sale arrangements, in other words to maintain the status quo, during the current winter heating season.

Pacific Gas and Electric Company intends to meet its contractual obligations to pay for gas in the ordinary course of business. However, in light of our current financial condition, we will not be able to maintain our liquidity and our ability to provide service to the public if we are forced to provide upfront cash prepayments to gas suppliers or pipeline operators, or to pay daily spot prices (as contrasted to monthly prices) for baseload gas supplies.

Please let me assure you that Pacific Gas and Electric Company is taking, and will continue to take, all reasonable steps to avoid the worst effects of this natural gas supply crisis. First, of course, we will continue to seek commercial resolution of problems with the suppliers. We also have initiated action for mutual assistance from other gas utilities in California, and other remedies within the jurisdiction of state authorities. But because California is almost entirely dependent upon gas imports from outside the state, and because of the fact that gas suppliers are already taking steps to stop sales to PG&E, causing a shortage to be imminent, we believe it is essential to the welfare of our utility customers that you invoke your emergency powers under the Natural Gas Policy Act and the Defense Production Act, as requested in this letter.

On behalf of Pacific Gas and Electric Company and its millions of natural gas and electric customers, we thank you for your consideration of this emergency request.

Sincerely,

A handwritten signature in dark ink, appearing to read "Gordon R. Smith". The signature is fluid and cursive, with the first name "Gordon" being more prominent.

Gordon R. Smith

cc:

Senator Dianne Feinstein

Senator Barbara Boxer

Honorable Bill Richardson

California Congressional Delegation

Governor Gray Davis

Honorable James J. Hoecker

Honorable Curt Hébert, Jr.

Honorable William L. Massey

Honorable Linda Key Breathitt

Honorable Loretta Lynch, President, California Public Utilities Commission

Honorable Michael A. Kahn, Chairman, California Electricity Oversight Board



**Pacific Gas and
Electric Company**

Gordon R. Smith
President and
Chief Executive Officer

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415.975.2165

January 12, 2001

The Honorable Gray Davis
Governor
California State Capitol Building
Sacramento, CA 95814

Re: Request to the President of the United States Regarding Natural Gas Supply
Emergency in Northern and Central California

Dear Governor Davis:

As I explained in an earlier letter to you on January 9, 2001, due to the financial crisis caused by wholesale electricity prices, Pacific Gas and Electric Company faces an imminent shortage of natural gas to deliver to its high priority ("core") customers -- homeowners and small businesses.

Today, I am writing to inform you that I have requested the President of the United States to issue an Emergency Declaration under the Natural Gas Policy Act of 1978 (15 U.S.C. §§ 3361-3364), and the Defense Production Act of 1950 (50 U.S.C. Appendix § 2071), and take steps to help ensure adequate gas supplies for core gas customers in northern and central California. A copy of my letter to the President, and supporting material, is enclosed.

I have informed the President that the financial crisis PG&E is facing because of high wholesale electricity prices has caused gas suppliers to refuse to sell gas to PG&E for core customers (i.e., residential and small commercial customers) for future periods commencing as early as next month (February 2001), and may cause them to suspend deliveries in January under existing gas contracts. In fact, since I last wrote to you, one large supplier, J. Aron & Company, which accounts for approximately 12 percent of our flowing gas volumes, has terminated deliveries to PG&E. We also face the threat that pipeline service providers may attempt to suspend service. These problems are arising

because of the larger financial crisis, despite the fact that PG&E currently has the legal and regulatory authority to collect virtually all of our gas costs in future rates.

I have explained to the President that, unless he and the Secretary of Energy act immediately under the President's emergency powers, we fear that PG&E's current credit crisis could lead to curtailments (gas outages) to high priority users *during the next few days or weeks and through the winter months*. Such an emergency would result in a gas shortage, which in turn would threaten the health and safety of millions of Californians in the northern and central portions of our state. In addition, because natural gas in a shortage will be diverted from non-core customers, including gas-fired power plants, the gas supply emergency could worsen the electricity supply crisis faced by PG&E and other utilities in California.

In light of these emergency circumstances, I have asked the President to exercise his emergency statutory powers, and require gas suppliers to continue to sell gas to PG&E, at monthly prices and without special credit assurances, and to enter into future gas purchase arrangements with PG&E along these lines.

As Governor of California, however, you also have an essential role to play in fully implementing steps to alleviate shortages when a natural gas emergency is invoked. Under the Natural Gas Policy Act, with a notification from you, as Governor, that a natural gas shortage exists or is imminent in northern and central California, the President then would have the power to allocate gas supplies from interstate pipelines to PG&E's high-priority core customers under certain conditions to alleviate the shortage. We believe that such an allocation of pipeline supplies may become necessary to avert a severe natural gas shortage in northern and central California, because of the large amount of gas PG&E obtains from Canada, and the possibility that Canadian suppliers might contest the President's order. In that circumstance, it may be necessary to divert domestic gas from interstate pipelines in the United States to serve PG&E's high-priority core markets.

Please let me assure you that Pacific Gas and Electric Company is taking, and will continue to take, all reasonable steps to avoid the worst effects of this natural gas supply crisis. First, we will, of course, continue to attempt to reach commercial solutions to our problems with gas suppliers. We also intend to seek emergency assistance from Southern California Gas Company. But we are very concerned that these measures, no matter how successful, cannot avoid an imminent and potentially severe gas shortage, beginning as early as next month and possibly even sooner. It is for this reason that we are urgently requesting your assistance, and the assistance of the President, under the President's emergency powers.

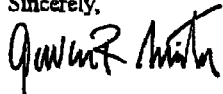
Accordingly, Pacific Gas and Electric Company hereby requests that you declare that a natural gas supply shortage is imminent in northern and central California, for the reasons provided in PG&E's letter to the President and supporting documents. We request that you immediately notify the President of this finding, and that you ask the President to authorize the Secretary of Energy to order, as necessary, an allocation of interstate pipeline supplies for the benefit of Pacific Gas and Electric Company's core customers.

Specifically, we ask you to:

- Notify the President immediately that there is an imminent natural gas supply shortage in northern and central California, as provided in 15 U.S.C. section 3363(c)(2).
- Make a finding that the shortage endangers the supply of natural gas for PG&E's Core customers (who are defined as "high priority" customers under the NGPA), and that federal government intervention is appropriate, to the full extent permitted by federal law.
- Make a further finding that the exercise of authority under State law is inadequate to protect PG&E's Core customers from an interruption in gas supplies.

Thank you for your consideration of this request.

Sincerely,



Gordon R. Smith

Enclosure (Letter to the President)

cc:

President William J. Clinton
 Senator Dianne Feinstein
 Senator Barbara Boxer
 California Congressional Delegation
 Hon. William Richardson
 James J. Hoecker
 Loretta Lynch
 Michael A. Kahn



Gordon R. Smith
President and
Chief Executive Officer

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415.973.2155

January 9, 2001

The Honorable Gray Davis
Governor
State of California
State Capitol
Sacramento, CA 95814

Re: Natural Gas Emergency For Northern and Central California

Dear Governor Davis:

Due to its worsening credit situation and the continued increases in the cost of gas over the amounts allowed to be collected in retail rates, Pacific Gas and Electric Company faces an imminent shortage of natural gas for delivery to its Core customers – homeowners and small businesses. This shortage may require you to invoke your emergency authority under Government Code Sections 8550, et. seq. We are alerting you to this situation so that you can initiate any actions available to address this impending emergency.

Pacific Gas and Electric Company's deteriorating credit situation is causing gas suppliers to decline to sell Pacific Gas and Electric Company any more gas, even under existing gas contracts, in the absence of accelerated payments. We are very concerned that the current credit crisis is about to devolve into an unprecedented emergency in the gas industry, which could lead to curtailments (gas outages) to high priority users *during these winter months*. That emergency will result in a gas shortage, which will threaten the health and safety of millions of Californians in the northern and central portions of the State.

This natural gas shortage will begin to occur *in the next few days* as gas suppliers are already cutting off natural gas supplies because of negative action on Pacific Gas and Electric Company's credit rating and gas suppliers' fears that Pacific Gas and Electric Company will not be able to pay for gas supplies on a timely basis and will file for bankruptcy protection. Specifically, gas suppliers have 1) made demands that Pacific Gas and Electric Company provide prepayment, COD, or other forms of payment assurance for gas supplies, which Pacific Gas and Electric Company is unable to meet given its current cash reserves; and 2) have refused to sell gas to Pacific Gas and Electric Company for future periods commencing as early as the end of this week. Although we have told suppliers that we expect to be able to continue to make

required gas payments on the normal billing cycle, those assurances have not been adequate to calm supplier concerns.

We provide gas service to our Core customers by purchasing approximately 1 billion cubic feet of gas each day, from approximately 20-25 gas suppliers on any given day, most of whom are out of state suppliers. Without those purchases, we cannot provide gas for heating and other essential uses for our small customers.

If our suppliers refuse to sell and deliver gas to Pacific Gas and Electric Company, the only supplies available to Pacific Gas and Electric Company to keep supplying our loads will be gas currently held in storage, and to a limited extent gas diverted on an emergency basis from industrial customers – including in-state electric generators. Without the gas supplies currently under contract, gas available to serve high priority customers will be depleted within several weeks, and possibly sooner if temperatures fall below normal. At that point, home gas furnaces, stoves and water heaters would go off. Long before that we would expect electric shortages to begin to appear as gas is diverted from use for electric generation.

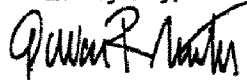
Please let me assure you that Pacific Gas and Electric Company is taking, and will continue to take, all reasonable steps to avoid the worst effects of this natural gas crisis. First, we will of course continue to attempt to reach commercial solutions to our problems with gas suppliers. Second, we are asking the California Public Utilities Commission for emergency authorization that would, among other things, allow Pacific Gas and Electric Company to draw upon gas supplies from Southern California Gas Company – and we hope you will enthusiastically support such a request. Third, while Pacific Gas and Electric Company has the ability to request from the CPUC diversions of non-core gas supplies, approximately two-thirds of the divertible gas on Pacific Gas and Electric Company's gas system currently is consumed by electric generators. Therefore, any diversions of non-core gas will decrease the level of electric generation in Pacific Gas and Electric Company's service territory and lead to worsening outages on the electric system. For this reason, diversions of non-core gas supplies in order to avoid shortages to core customers will only aggravate the combined gas and electric supply crisis. Finally, we are exploring with the Department of Energy the extent to which any emergency federal powers can be brought to bear on this emergency.

This is a credit-based shortage, not a physical supply shortage. There are sufficient gas supplies for delivery to California as of today. However, gas suppliers' unwillingness to sell to Pacific Gas and Electric Company renders the gas unavailable to those who need it most in winter – our Core customers.

Our customers will need your help. The critical issue is that the State under its emergency powers must step in to provide temporary financial assistance sufficient to meet the demands of gas suppliers. Thus, it would be particularly wise to explore whether the State can function as an interim purchaser or otherwise provide credit.

Please let us know how we can be of assistance.

Yours very truly,

A handwritten signature in dark ink, appearing to read "Gordon R. Smith", written in a cursive style.

Gordon R. Smith

cc: Lorena Lynch, CPUC President
Michael A. Kahn, Chairman, Electric Oversight Board
Lynn Schenk, Chief Aide and Senior Counsel, Office of the Governor