Decision **DRAFT DECISION OF ALJ BARNETT** (Mailed 7/23/02)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Applications of Pacific Enterprises, Enova Corporation, Mineral Energy Company, B Mineral Energy Sub and G Mineral Energy Sub for Approval of a Plan of Merger of Pacific Enterprises and Enova Corporation With and Into B Energy Sub ("Newco Pacific Sub") and G Energy Sub ("Newco Enova Sub"), the Wholly-Owned Subsidiaries of A Newly Created Holding Company, Mineral Energy Company.	Application 96-10-038 (Motion filed July 19, 2001)

(See Appendix B for Appearances)

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OPINION APPROVING CONSULTANT'S REPORT WITH MODIFICATIONS

Background

In Decision (D.) 98-03-073, the Commission approved the merger of Enova Corporation and Pacific Enterprises, subject to certain conditions. One of those conditions was that "Applicants shall consent to the hiring of an independent firm to ensure compliance with applicable safeguards." (D.98-03-073, Ordering Paragraph (2)(e), mimeo, p. 146.) We ordered the Executive Director to contract with an independent firm to monitor, audit, and report on how Southern California Gas Company (SoCalGas), the principal subsidiary of Pacific Enterprises, and San Diego Gas & Electric Company (SDG&E), the principal subsidiary of Enova Corporation, have complied with the merger conditions set forth in Attachment B to D.98-03-073.

The Commission approved a contract with Larkin & Associates (Larkin) to conduct the audit. Larkin, in due course, delivered its report to the Commission's Energy Division. In April, 2001, Sempra Energy, the parent company of SoCalGas and SDG&E, was provided the Larkin report by the Energy Division and was asked for its comments, including the identification of those portions of the report that should be kept confidential. Sempra Energy provided its comments to the Energy Division, including it reasons why certain sections of the report should be kept confidential.

Sempra Energy has provided copies of the Larkin report to both The Utility Reform Network (TURN) and Southern California Generation Coalition (SCGC), whose representatives have executed confidentiality agreements. The Office of Ratepayer Advocates (ORA) received a copy of the Larkin report. The report is in three volumes, which have been admitted into evidence.

Confidentiality

Sempra Energy requests confidential treatment of certain material in the audit report.

Volume 1

Sempra Energy requests confidentiality to the paragraph immediately above the "Findings and Conclusions" on p. 4-8. This paragraph discusses an interview Larkin conducted with a Senior Vice President of a Sempra Energy subsidiary that is not regulated by the Commission, and specifically refers to a statement that was made in an economic analysis contained in a strategic plan of this Sempra Energy subsidiary which, Sempra Energy asserts, would cause competitive harm to this Sempra Energy subsidiary if made public. We have reviewed the paragraph at issue and find that making public will not cause competitive harm, and therefore will not be treated confidentially.

Volume 2

Sempra Energy identified Exhibits 3-D-1, 3-G-1, 3-G-2, 5-C-RMSP14-1, 5-C-RM 14-2, and 5-C-RM 15-11 of Volume 2 as requiring confidential treatment for the reason that these pages contain names and phone numbers of employees of SoCalGas and SDG&E. Sempra Energy requests that the names and phone numbers be redacted for security reasons. We agree with Sempra Energy. For security reasons the material specified will be redacted.

Volume 3

This volume consists of summaries of the interviews conducted by Larkin of employees of Sempra Energy and its subsidiaries. Sempra Energy requests that all of Volume 3 be kept confidential because these interviews were conducted with the understanding that they would be kept confidential, and Sempra Energy was never informed during the audit process that these

interviews would be made part of the audit report subject to public review. Sempra Energy understood that the interviews were intended to provide background and general information to Larkin to assist its understanding of organizational relationships and functions. Further, the interview summaries contained in Volume 3 are interspersed with individual customer names and with highly sensitive commercial information, disclosure of which would place Sempra Energy and/or its subsidiaries at a competitive disadvantage.

Sempra Energy explains that it would be unwise to make the interview summaries public because they were never understood by the interviewees to be subject to public disclosure. In the future, employees involved in Commission-ordered audits would understandably be reluctant to be as candid and forthcoming as possible with the auditors if they suspect that the audit interview summaries would be made public, thus undermining the audit process itself. Sempra Energy submits that, for these reasons, the entire Volume 3 should be kept confidential.

These interviews were reviewed by the parties and no portion of Volume 3 was referred to on the record. In the interest of obtaining the most candid of replies, we believe interviews such as those conducted by Larkin should be accorded confidentiality until the public interest is shown to outweigh the protection. In this case no party has shown that the public interest requires non-confidential treatment of the interviews. The entire Volume 3 will be kept confidential.

The Larkin & Associates Report

The purpose of the report is for the consultant to monitor, review, and report on the combined utilities' compliance with the market power safeguards adopted in D.98-03-073, determine how they operate their gas system, and

determine whether the companies offer open and nondiscriminatory service as required in the decision.

The primary objectives were to:

- Review and evaluate how the combined utilities operate their gas system;
- Review and evaluate the combined utilities' compliance with adopted safeguards to ensure open and nondiscriminatory service;
- Review and evaluate the combined utilities' compliance with the restrictions and guidelines in Section I, II, and III of Attachment B of D.98-03-073 and to raise concerns of market power abuses identified during the review;
- To analyze the merged utilities' market power position and determine if they are abusing their market power; and
- Report on the merged utilities' transportation policy and operation, any violation of the Commission's remedial measure safeguards, and advise the Commission whether it needs to implement additional safeguards in order to ensure that the merged utilities do not abuse their gas transmission market power.

The scope of the review was broad in nature relative to addressing project objectives. The review commenced on June 16, 1999, and was completed in July 2000.

The report is presented in three volumes. Volume 1 contains the body of the report, and the discussion is presented in six chapters:

1. Executive Summary
2. Objectives and Approach
3. Operation of the Combined Utilities' Gas System
4. Compliance with Market Power Safeguards Adopted in Commission D.98-03-073
5. Compliance with 25 Remedial Measures
6. Market Power

Volume 2 contains exhibits that are referenced in Volume 1 of the report. The exhibits are organized to correspond with the chapter and section in Volume 1 in which they are first discussed.

Volume 3 contains a listing of the interviews that were conducted during the review and analysis, and the interviewees' signed and corrected interview summaries.

The recommendations for each area of review discussed in Chapters 4, 5, and 6 of Volume 1 of the report are organized and numbered according to the chapter and section of the report in which each area of review is addressed.

The three volumes of the report have been received in evidence subject to the confidentiality treatment discussed above. All references to the report in this opinion are confined to Volume 1, which is completely open to the public.

D.98-03-073 required the merged companies to comply with 25 remedial measures. (Those measures are set forth in Appendix A of this decision.) The merged companies developed compliance policies and guidelines for implementing each of the 25 remedial measures. The merged companies identified departments which could be impacted by the remedial measures and assigned responsibility to the directors of those departments. The policies and guidelines for remedial measure compliance were widely disseminated through the merged companies' organization. Accountability for compliance with each remedial measure is specified in Sempra's Remedial Measure Compliance Guidelines and is summarized in an Accountability Matrix. The Larkin report finds that the Accountability Matrix generally represents an appropriate summary of responsibility for remedial measure compliance. However, as discussed in more detail in Chapter 5 of Volume 1 under each remedial measure, some additions and deletions are recommended to assure compliance.

The Larkin report is voluminous. The three volumes comprise 600 pages, which are commentary on the 25 remedial measures imposed by D.98-03-073. Non-controversial items are not discussed in this opinion. We have set forth the recommendations which are relevant toward modifying the remedial measures of D.98-03-073. It is important to observe that ORA, TURN, and SCGC read and commented upon the Larkin report and Sempra Energy's response. ORA, TURN, and SCGC have recommended only four changes to Sempra Energy's proposals. Their recommendations support the Larkin report in its recommendation 4-D-1, 5-C-RM 13-3, 5-C-RM 13-4, and 6-C-2; all of which are discussed below. To keep this opinion reasonably concise we do not discuss the Larkin report findings and conclusions which do not affect the remedial measures of D.98-03-073. Except as noted below, we adopt the Larkin report recommendations with the modifications proposed by Sempra Energy. In the section "Intervenor Supported Recommendations," we discuss the four controversial recommendations and adopt one (6-C-2).

Recommended Changes to the Accountability Matrix

The report makes 18 recommended changes to the accountable organizations shown in the remedial measures (RMs) Accountability Matrix. This includes changes to accountability for RM1, RM2, RM3, RM5, RM6, RM7, RM9, RM11, RM12, RM15, RM17, RM18, and RM24/25. Sempra Energy has no objection to these Larkin recommendations and will adopt Larkin's proposed changes to the Accountability Matrix. As the report recommends, this revised matrix will be provided to all affected organizations throughout Sempra Energy and will be periodically updated.

Recommendation 5-C-RM4-1

Personnel in the affected departments should verify synchronization of the clock on the NiceLog machines to the GasSelect clock and the Gas Scheduling (and Gas Control-Spence Street) wall clocks, preferably daily.

Sempra Energy Response

Synchronization of the clocks among the NiceLog systems, GasSelect® Gas Scheduling and Gas Control has been accomplished. SoCalGas has purchased the Auto Time Synch feature for the NiceLog recording system. This enhancement automatically synchronizes the GasSelect® clock with the NiceLog clock. Installation was completed in August of 2001. Manual updates are no longer necessary.

Recommendation 5-C-RM4-2

All personnel in the Gas Scheduling department (Four Gas Schedulers and one Manager) should be shown how to verify the date and time shown on the NiceLog machine clock with the GasSelect clock and should be shown how to adjust the NiceLog clock to keep it synchronized with the Gas Select clock.

Sempra Energy Response

This recommendation was implemented with the installation of the system noted above in connection with 5-C-RM4-1.

Recommendation 5-C-RM11-2

A periodic verification should be completed to determine that all instances of tariff discretion are posted to the tariff discretion log within the required two days.

Sempra Energy Response

Past internal reviews of the tariff discretion log have revealed that instances of tariff discretion not being posted within the required two-day timeframe have been rare and were usually caused by computer software problems associated with the log. The tariff discretion log reports will be reviewed monthly to make sure all tariff discretion log entrees are made within the required two days. Additionally, past computer problems that may have caused a few entries to be made outside the required two-day timeframe have been completely fixed. When one considers the fact that no outside party has ever asked to review this log, it is clear that this is a non-issue.

Recommendation 5-C-RM12-1

Record all telephonic conversation in Gas Scheduling and maintain phone logs for any unrecorded lines (i.e., cellular phones and Gas Scheduling Manager's "administrative" line).

Sempra Energy Response

SoCalGas maintains call accounting phone bills that provide a phone log. SoCalGas sees no value in a duplicative log since logs do not record content, only time & phone number. Management will take action to reinforce to all Gas Scheduling employees that, whenever feasible, conversations regarding gas scheduling transactions shall be made on recorded lines. Phone bills will be kept for a minimum of three years. These procedures are entirely adequate and therefore this recommendation should be deleted or not adopted by the Commission.

Recommendation 5-C-RM12-3

Periodically reconcile phone logs with their invoices to verify that all calls have been logged.

Sempra Energy Response

See comment on 5-C-RM12-1. Since no new logs are necessary, this recommendation should be deleted or not adopted by the Commission.

Recommendation 5-C-RM12-4

The use of common computer support personnel by these departments raises a concern that the personnel serving both departments could serve as a conduit of non-public information between Gas Operations and Gas Acquisition. The use of shared personnel between these departments should be avoided whenever practical.

Sempra Energy Response

SoCalGas has also been concerned that common computer support might present a potential conduit of information between these two departments. As a result, SoCalGas took steps to ensure that computer support personnel who provide desktop support and interact with each department's users do not share responsibility for supporting both the Gas Operations and Gas Acquisition departments. In addition, personnel supporting these two departments are not provided access to the other department's restricted areas.

Recommendation 5-C-RM12-5

Gas Scheduling should retain email messages.

Sempra Energy Response

Gas Scheduling now retains e-mail messages received from and sent to shippers (including SoCalGas' Gas Acquisition, SDG&E Fuel and Power Supply and any other affiliate). The messages are retained for a minimum of 3 years.

Recommendation 5-C-RM13-1

Remedial measure 13 should be revised/clarified to explicitly mention SDG&E Fuel and Power Supply and energy marketing affiliates, along with Gas Acquisition.

Sempra Energy Response

Sempra Energy has no objection to this recommendation. In fact, for internal purposes such as training, Sempra Energy has revised RM 13 to explicitly mention SDG&E Fuel and Power Supply and energy marketing affiliates.

Recommendation 5-C-RM13-2

SoCalGas Seasonal and Operational Plans and other documents used in Gas Operations should consistently contain notifications concerning restrictions on distribution.

Sempra Energy Response

Sempra Energy agrees with this recommendation. SoCalGas Seasonal and Operational Plans and other documents used in Gas Operations will consistently contain notifications concerning restrictions on distribution.

Recommendation 5-C-RM13-5

SoCalGas should consistently require that questions concerning transportation not specifically related to a shipper's transportation agreement be submitted in writing (or by email) to Gas Scheduling, and be responded to on GasSelect. The written inquiries should be retained by Gas Scheduling so verification can be made that all required postings were made.

Sempra Energy Response

SoCalGas posted a message on GasSelect®'s EBB on August 15, 2001, stating that any inquiries made not related to the shipper's own transportation agreement or to any public and/or posted information must be submitted via e-mail to Gas Scheduling @ gtcalendar@socalgas.com. Questions received will be responded to and posted in the Q&A section of the GasSelect® EBB so that the information will be made available to all parties contemporaneously. All such e-mails received will be kept on file for a minimum of three years.

Recommendation 5-C-RM14-1:

SoCalGas should maintain phone logs for cellular phone usage by the Gas Scheduling personnel. The volume of calls received/made via these cellular phones is relatively low so maintaining such logs should not present an unreasonable burden. Also, SoCalGas should periodically reconcile the phone logs to the invoices to determine if all calls are being logged.

Sempra Energy Response

See response to recommendation 5-C-RM12-1. Sempra Energy requests that this recommendation be deleted or not adopted by the Commission.

Recommendation 5-C-RM14-2

SoCalGas management and Sempra Energy Audit Services should periodically review calls recorded from Gas Scheduling to ensure compliance with remedial measures. Calls occurring near the four nomination deadlines should be reviewed in particular to assure non-discriminatory treatment in extending nomination deadlines.

Sempra Energy Response

Beginning with the third quarter of 2001, Gas Scheduling management began performing a self-audit of the phone calls in their group in order to ensure

compliance with the remedial measures. This includes calls occurring near the four nomination deadlines. Annually, Sempra Energy Audit Services will review Gas Scheduling's self audits and will also select an independent sample to test.

Recommendation 5-C-RM14-3

SoCalGas should implement daily verification and synchronization of time on the Gas Scheduling and Gas Control NiceLog and GasSelect clocks.

Sempra Energy Response

SoCalGas has implemented this recommendation.

Recommendation 5-C-RM14-4

SoCalGas should diligently utilize security precautions for recorded NiceLog tapes to prevent subsequent erasure or damage, i.e., utilize the "write tab" protector, change the default overwrite protection on all recorded tapes to 48 months or more, and keep the recorded tapes in a secured area.

Sempra Energy Response

SoCalGas has diligently utilized security precautions for recorded NiceLog tapes to prevent subsequent erasure or damage.

Recommendation 5-C-RM14-6

Sempra Energy should work with the NiceLog vendor to develop a more efficient method for reviewing recorded calls.

Sempra Energy Response

SoCalGas contacted the NiceLog Systems vendor to explore possible enhancements and/or an upgrade of the current system in order to develop a more efficient method for reviewing recorded calls. NiceLog has advised SoCalGas that the "discounted price" for an updated version would run approximately $42,000. This cost far outweighs the need for any perceived

efficiency. Accordingly, Sempra Energy requests that this recommendation be deleted or not adopted by the Commission.

Recommendation 5-C-RM15-1

The statement of remedial measure 15 should be broadened to encompass not just futures positions but other types of transactions, which constitute positions in the energy market. Remedial measure 15 should also be broadened to preclude Sempra Energy marketing affiliates from receiving non-public information concerning SoCalGas Gas Operations and Gas Acquisition.

Sempra Energy Response

To comply with this recommendation, RM 15 has been broadened for internal purposes to encompass not just futures positions but other types of transactions which constitute positions in the energy market. RM 15 will also be broadened for internal purposes to preclude Sempra Energy marketing affiliates from receiving non-public information concerning SoCalGas Gas Operations and Gas Acquisition.

Recommendation 5-C-RM15-3

Sempra Energy should diligently adhere to its policy concerning "anti-conduit" procedures. This would include requiring the appropriate training and obtaining the appropriate acknowledgement forms from personnel upon their employment. Personnel in departments that receive sensitive non-public information should not be functioning for indefinite periods without having read and acknowledged the Sempra Energy "anti-conduit" policy, as evidenced by their submission of the required signed acknowledgement forms.

Sempra Energy Response

Sempra Energy currently has in place anti-conduit procedures that require all new employees to read and acknowledge the Sempra Energy anti-conduit policy by the end of the day on which their new employee orientation occurs. Additionally, the Affiliate Compliance Department requires all Sempra Energy personnel on an annual basis to revisit and understand the anti-conduit procedures. Sempra Energy therefore is in compliance with this recommendation.

Recommendation 5-C-RM20-1

SoCalGas should continue to maintain its GasSelect EBB in a manner providing for high user accessibility and minimal downtime.

Sempra Energy Response

SoCalGas will continue to maintain its GasSelect® EBB in a manner providing for high user accessibility and minimal downtime.

Recommendation 5-C-RM20-2

SoCalGas should continue to make required postings on GasSelect within one hour of an executed transaction of the receipt/transmission of any relevant information.

Sempra Energy Response

SoCalGas will continue to make required postings on GasSelect® within one hour of an executed transaction of the receipt/transmission of any relevant information.

Recommendation 5-C-RM20-4

SoCalGas should evaluate the feasibility, need, and implementation cost of the GasSelect improvements identified by the SDG&E Gas Schedulers, and should report to the CPUC within 90 days after the formal issuance of this report.

Sempra Energy Response

SoCalGas hereby reports to the Commission regarding the improvements identified by the SDG&E Gas Schedulers.

1. Presentation of important information.

Nova Pipeline's bulletin board has a feature that forces the user to immediately read alerts and important messages when logging on before proceeding to the desired function. On GasSelect®, the user must navigate through a number of different areas to find such information.

Response

SoCalGas is in the process of upgrading the software technology for GasSelect® to more closely resemble the Bulletin Board of interstate pipelines. SoCalGas plans to follow the approved GISB requirements for EBBs.

2. Availability of historical transaction data for a more extensive time frame than just the most recent three months.

Another useful feature would be the ability to access historical information beyond three months. This information is used frequently for back office procedures such as reconciliations. Currently transaction information going back prior to three months is not available on GasSelect.

Response

Accessing historical information on GasSelect® for all transportation customers for more than three months should not be required as it would slow down the response time when accessing GasSelect® (e.g., submitting

nominations, viewing information). SoCalGas will evaluate the feasibility of expanding historical information access as part of its next technology upgrade in the fall of 2001.

* * *

3. A method for having the system automatically renominate gas for each cycle, rather than having to do it manually four times (once for each cycle).

Other pipelines (e.g. El Paso, ANG, PGT) provide this feature.

Response

This enhancement will take place with the next upgrade of GasSelect® currently scheduled for fall of 2001.

Recommendation 5-C-RM24/25-2

Remedial measures 24 and 25 apply to "any customer" and "any shipper," respectively. Sempra Energy's Policy and Guidelines for remedial measures 24 and 25 should be revised to reflect that these remedial measures apply to "any customer" and "any shipper," respectively.

Sempra Energy Response

In accordance with this recommendation, Sempra Energy's Policy and Guidelines for remedial measures 24 and 25 will be revised.

Intervenor Supported Recommendations

Recommendation 6-C-2

Because any conveyance of non-public utility information would be extremely difficult to detect, precluding the opportunity for the potential conveyance of such information coupled with an anti-conduit policy would represent a stronger safeguard than would an anti-conduit policy by itself. The value of any utility proprietary information not available to the public, such

as Gas Acquisition's plans and strategy, would tend to decay as time passes. The "value at risk" analyses performed by Sempra Energy Risk Management show that the risk of utility operations, such as SoCalGas Gas Acquisition, to adverse energy price fluctuations is rather limited compared with the energy market activities of affiliates such as Sempra Energy Trading. While Sempra Energy Risk Management must consider the risk of the utility, its major focus, and by far the major element of energy market risk, is with affiliates such as Sempra Energy Trading. Therefore, the Commission should require a reasonable delay period, such as a week, in having sensitive information on utility gas acquisition and trading plans submitted from SoCalGas Gas Acquisition to Sempra Energy Risk Management. Such a delay period would lessen any existing opportunities for potential improper conveyance of such information, since, with the imposed time lag, the value of such information to an affiliate market participant would deteriorate. Consequently, Intervenors support the Larkin report on this issue and recommend that real-time access by Sempra Energy Risk Management to SoCalGas Gas Acquisition and SDG&E Fuel and Power Supply department information on gas purchasing plans be delayed for a week or longer.

Sempra Energy Response

This recommendation is opposed because it would disable Sempra Energy from employing appropriate risk management if information regarding trading plans and activities is not made available on a timely basis. In addition, there is no evidence or findings of conduit violations.

Discussion

TURN urges the Commission to recognize the seriousness of the threat posed by the situation described in Recommendation 6-C-2, and the need to take

preventive steps to mitigate that threat. TURN supports a reasonable delay in submitting sensitive information to Sempra Energy Risk Management.

TURN refers us to Section 6.C. of the report which describes the following:

- The Sempra Energy Vice President of Energy Risk Management has access to the detailed trading activity and gas procurement plans of the SoCalGas Gas Acquisition and SDG&E Fuel and Power Supply departments. (Audit Report, p. 6-14.)

- This particular Vice President is also actively involved with the affiliated trading company, Sempra Energy Trading (SET), making this position "ideally situated as a potential conduit of non-public information on the utilities' gas acquisition and trading activities and plans to the affiliated trading company." (*id*. 6-15)

- While anti-conduit policies are in place, the Audit Report notes that "if [conveyance of non-public utility information to affiliates such as SET] was occurring it would be extremely difficult to detect. (*id*. 6-19)

TURN submits that the report makes clear that preventive measures are needed. This executive is particularly situated to gain access to time-sensitive non-public utility information and convey that information to unregulated affiliates. Larkin notes that on three of the twelve days selected because of the heavier-than normal SET trading activity in the California energy markets, there was direct contact between this executive and either the SoCalGas Gas Acquisition Committee or the SET staff. Although Larkin was careful to disclose that it could not draw a reliable conclusion based on such data, the data shortcomings appear to be of Sempra Energy's own creation.

We agree with TURN and Larkin. A risk manager needs information as current as possible so that risk and potential risk is mitigated. To have one executive with up-to-the-minute information regarding the activities of two entities which are expected to operate independently of each other is an invitation to manipulation or, almost as bad, the appearance of manipulation. Sempra Energy has affiliated transaction policies in place designed to prevent the improper disclosure of non-public utility information to energy marketing affiliates such as SET. To carve out an exception for the Sempra Energy vice president of risk management negates the entire process. The solution is to have each utility manage their own risks and report to higher management (*i.e.* Sempra Energy) on a delayed basis, as recommended by Larkin.

Recommendation 4-D-1

Larkin recommends that the Commission require the merged company to report to the Commission concerning the company's plan to integrate the operations of SoCalGas and SDG&E into a single business unit to assure that compliance with remedial measures, a number of which require separation of activities such as Gas Operations and Gas Acquisition, is not jeopardized.

In the merger proceeding, Pacific Enterprises and Enova Corporation were to become subsidiaries of a common parent company. However, their subsidiaries, SoCalGas and SDG&E, would remain separate companies. No lines, facilities, franchises, or permits of either SoCalGas or SDG&E were to be merged with or transferred to the other utility or any other entity. Both utilities are supposed to remain as they were pre-merger—regulated in their tariffed utility services by the Commission, having no change in the status of their outstanding security or debt, having the same assets and liabilities, and both still under the ownership of their respective parent holding companies.

During the investigation, Larkin learned that teams of Sempra Energy corporate center and utility employees have begun working to integrate the operation of SoCalGas and SDG&E into a single business unit by the end of the year. SoCalGas and SDG&E will remain separate legal entities and would not be merged, but as the result of the integration effort would function as a single business unit under common management. From this recent development, it appears that merged company management no longer intends to operate SoCalGas and SDG&E as independent utilities. Therefore, Larkin recommends that Sempra Energy report its plan to integrate the operations of SoCalGas and SDG&E.

Sempra Energy Response

In D.98-03-073, the Commission decided not to adopt the affiliate rules for utility-to-utility transactions, with certain exceptions not relevant here, specifically to maximize efficiencies, and in doing so, specifically identified those services that cannot be shared.

SDG&E and SoCalGas have sought permission from the Commission to integrate the two utilities. The utilities filed such a request in this proceeding in September of 2000. The filing asked the Commission to review integration plans and decide whether Sempra Energy must seek any additional authority to integrate the utilities, based upon what was already decided by the merger decision. This was approved in D.01-09-056. Accordingly, Sempra Energy has complied with this recommendation by seeking Commission guidance on its utility integration efforts.

Furthermore, in the merger proceeding itself, applicants made and then withdrew a proposal to integrate the two utilities' Gas Acquisition functions, but the Commission in D.98-03-073 allowed the two utilities to propose integration of

their Gas Acquisition functions in a future filing. On January 11, 2001, SoCalGas and SDG&E filed A.01-01-021, asking among other things to integrate their Gas Acquisition functions and their gas supply portfolios. The matter was submitted on July 30, 2001, after hearings. Thus, SoCalGas and SDG&E have already complied to the extent this merger audit recommendation means that they should seek Commission approval prior to integrating their Gas Acquisition functions.

Discussion

SCGC opposes the request of Sempra Energy that Recommendation 4-D-1 be deleted or expressly not adopted by the Commission. SCGC claims that merely because SDG&E and SoCalGas have submitted an application to merge their gas supply portfolios does not obviate the need for the report required by Recommendation 4-D-1. SCGC supports the report on this point and argues that the Commission and other parties need to know the overall scheme of Sempra Energy in regard to the two utilities.

Sempra Energy points out that SDG&E and SoCalGas specifically sought permission from the Commission to integrate certain functions of the two utilities in a filing made in this proceeding in September 2000. In D.01-09-056, the Commission discussed the request of Sempra Energy to consolidate certain utility functions and granted Sempra Energy's request. The recommendation in the Larkin report which preceded Sempra Energy's filing with the Commission has been overtaken by Sempra Energy's subsequent filing and the Commission's resolution of this matter in D.01-09-056. Sempra Energy further notes that it had sought Commission approval in A.01-01-021 to integrate the gas supply portfolios of the two utilities, an integration not addressed in the earlier filing in this merger proceeding. Sempra Energy concludes there is no integration

proposal that has not since been presented to the Commission for its approval, and therefore no further report is necessary.

We agree with Sempra Energy. Company plans, if any, to merge the operations of the two utilities will be known when a filing is made with the Commission. We have no need to know preliminary discussions and certainly the competitors of the utilities have no need to know.

Recommendation 5-C-RM13-3:

> Where an over-nomination situation could occur, the practice of posting the Hub position on GasSelect on a daily basis should be applied consistently.

SCGC supports this recommendation; Sempra Energy opposes.

The operations of the SoCalGas Hub involve the sale of parking and loaning services to noncore customers. These sales generate revenues that are split 50/50 between SoCalGas shareholders and core ratepayers under SoCalGas' Gas Cost Incentive Mechanism. SCGC argues that posting the Hub's "net in" position during overnomination situations might affect Hub revenues derived from selling the parking and loaning services, but it would be unlikely to affect Gas Acquisition's gas purchasing activities. The plea that Gas Acquisition's purchase of gas for the core would be harmed is hollow.

SCGC says that even if Sempra Energy were correct, however, the recommendation should still be adopted. The posting of Hub "net in" positions is necessary for there to be monitoring of Hub activities that might aggravate over-nomination events. The offering of Hub services is discretionary. If Gas Acquisition believes the offering of Hub services (and the concomitant generation of revenues) or the posting of "net in" positions would be detrimental

to Gas Acquisition's gas purchasing activities, Gas Acquisition has the discretion to reduce or modify its offerings of parking and loaning services.

Sempra Energy says that SCGC ignores the harm that could occur to SoCalGas' core customers if information regarding Gas Acquisition's Hub transactions is made available to sophisticated market participants such as SCGC members Reliant and Williams. No other market participant is required to post its daily position or obligation and to require the core to do so would give other market participants a significant competitive advantage. Such entities could "front-run" SoCalGas' core transactions which would result in higher costs to core customers.[4]

Sempra Energy contends that it is not necessary for the marketplace to monitor the SoCalGas Hub so that a party (such as SCGC) might inform the Commission if the SoCalGas Hub maintains a "net in" position on an over-nomination day. The Commission oversees the SoCalGas Hub and the Commission staff performs an annual audit of all SoCalGas Gas Acquisition activities, and therefore any concern of the Commission can be readily identified by its own staff. Moreover, there is no Commission decision which requires the

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[4] Sempra Energy defines 'front running' as simply taking advantage of a known position before the party that holds the position can exit that position. For example, if the market knows the exact amount of gas that SoCalGas Hub parties must shed to allow the Hub not to maintain a "net in" position, the market will sell gas short before the Hub parties can sell their gas (front run) and will drive down the price so that when the Hub gas becomes available on the market, the price is lower than it normally would have been. The Hub parties then sell their gas (as they must under the rules if required by the Hub) and drive the price down further at which time the front-runners then cover their short sale and buy back their position. This would adversely affect use of the Hub by the parties who suffer the losses caused by front running, thereby reducing Hub revenues shared with SoCalGas' core customers.

Hub to refrain from maintaining a "net in" position during an over-nomination day.

We agree with Sempra Energy. We see no reason to approve a policy which will benefit speculators in gas futures at the expense of core customers.

Recommendation 5-C-RM13-4:

> The Commission should consider assessing an "imbalance penalty" on SoCalGas for the over-nomination days when the Hub remained in a "net in" position.

Sempra Energy opposes a requirement that the Commission assess an imbalance penalty on SoCalGas for over-nomination days when the Hub remains in a "net in" position. It argues that there were only three occurrences, all in 1998, where the Hub maintained a "net in" position during over-nomination days. Further, Sempra Energy states that SoCalGas has since taken the corrective measures necessary to make sure that the SoCalGas Hub does not maintain a "net in" position during over-nomination days.

SCGC says that SoCalGas' implementation of corrective measures to assure that the SoCalGas Hub does not maintain a "net in" position during over-nomination days is commendable, but it believes an imbalance penalty should be imposed on SoCalGas if the Hub remains in a "net in" position during an over-nomination event. An imbalance penalty would insure accurate performance by SoCalGas. If SoCalGas' corrective measures are, in fact, in place and are operating correctly, SoCalGas will not be liable for any imbalance penalties.

Discussion

SoCalGas has agreed to a penalty structure in relation to the total activities of SoCalGas Gas Acquisition in the GIR proceeding (I.99-07-003). This penalty structure was addressed in the context of many fundamental changes to the rules

regarding SoCalGas' system operations, including tighter balancing requirements and specific receipt point access rights, and did not distinguish between SoCalGas' Hub activities and its other activities undertaken on behalf of core customers. (See D.01-12-018 p. 63.) Having considered penalties for SoCalGas in D.01-12-018, we need not go over this ground again.

The draft decision of ALJ Barnett in this matter was mailed to parties in accordance with Public Utilities Code § 311(g)(1) and Rule 77.7 of the Commission's Rules of Practice and Procedure.

Findings of Fact

1. Confidential treatment of the Larkin report is granted for Volume 2, Exhibits 3-D-1, 3-G-1, 3-G-2, 5-RM14-1, 5-C-RM14-2, and 5-C-RM15-11, because those pages contain names and phone numbers which should be redacted for security reasons.

2. Volume 3 of the report is granted confidential treatment in the interest of obtaining candid replies to internal surveys.

3. The Larkin report's proposed changes to the Accountability Matrix are adopted.

4. Recommendations 5-C-RM4-1, 5-C-RM4-2, and 5C-RM11-2 are adopted.

5. Recommendations 5-C-RM12-1 and 5-C-RM12-3 are not adopted.

6. Recommendation 5-C-RM12-4, 5-C-RM12-5, 5-C-RM13-1, 5-C-RM13-2, and a 5-C-RM13-5 are adopted.

7. Recommendation 5-C-RM14-1 is not adopted.

8. Recommendations 5-C-RM14-2, 5-C-RM14-3, and 5-C-RM14-4 are adopted.

9. Recommendation 5-C-RM14-6 is not adopted.

10. Recommendations 5-C-RM15-1, 5-C-RM15-3, 5-C-RM20-1, 5-C-RM20-2, 5-C-RM20-4, and 5-C-RM24/25-2 are adopted.

11. Recommendation 6-C-2 is adopted. The Sempra Energy Risk Management department shall not receive time-sensitive non-public information from the SoCalGas Acquisition and SDG&E Fuel and Power Supply departments on a timely basis. There shall be at least a seven-day delay in providing such information.

12. Recommendation 4-D-1 is not adopted.

13. Recommendations 5-C-RM13-3 and 5-C-RM13-4 are not adopted.

14. The Larkin Report has assured compliance with applicable safeguards as required by D.98-08-073 and is approved, subject to the modifications set forth in this decision.

Conclusions of Law

1. Larkin & Associates have provided the Commission with a report that fulfills the condition of D.98-03-073, for an independent audit to monitor, audit, and report on compliance with the merger conditions.

2. The Larkin report is approved, subject to the modifications set forth in this decision.

3. SoCalGas, SDG&E, and Sempra Energy have complied with the merger conditions of D.98-03-073, but some modification of those conditions is needed.

O R D E R

IT IS ORDERED that:

1. Sempra Energy, Southern California Gas Company, and San Diego Gas & Electric Company shall forthwith implement the recommendations of the Larkin & Associates report which have been approved by this decision.

2. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.

Appendix A
Required Mitigation Measures

APPLICANTS' 25 REMEDIAL MEASURES

A. The Terms and Conditions of the tariff provisions relating to transportation shall be applied in the same manner to the same or similarly situated persons if there is discretion in the application of those tariff provisions. (Remedial Measure 1.)

B. SoCalGas shall strictly enforce a tariff provision for which there is no discretion in the application of the provision. (Remedial Measure 2.)

C. SoCalGas shall not, through a tariff provision or otherwise, give its marketing affiliates (including SDG&E) preference over non-affiliated shippers in matters relating to transportation including, but not limited to, scheduling, balancing, transportation, storage or curtailment priority. (Remedial Measure 3.)

D. SoCalGas shall process all similar requests for transportation in the same manner and within the same period of time. (Remedial Measure 4.)

E. SoCalGas shall not disclose to its marketing affiliates or to employees of SDG&E engaged in the gas or electric merchant function any information SoCalGas receives from a non-affiliated shipper or potential non-affiliated shipper. (Remedial Measure 5.)

F. To the extent SoCalGas provides information related to transportation of natural gas to its marketing affiliates or to employees of SDG&E engaged in the gas or electric merchant function, SoCalGas shall provide that information contemporaneously to all potential shippers, affiliated and nonaffiliated, on its system. (Remedial Measure 6.)

G. To the maximum extent practicable, SoCalGas' operating employees and the employees of its marketing affiliates, including employees of SDG&E engaged in the electric merchant function, shall function independently of each other. (Remedial Measure 7.)

H. If SoCalGas offers a transportation discount to a marketing affiliate, including the SDG&E gas or electric merchant function, or offers a transportation discount for a transaction on its intrastate pipeline system in which a marketing affiliate, or the SDG&E

gas or electric merchant function, is involved, SoCalGas shall make a comparable discount contemporaneously available to all similarly-situated non-affiliated shippers; and within 24 hours of the time at which gas first flows under a transportation transaction in which a marketing affiliate receives a discounted rate or a transportation transaction at a discounted rate in which a marketing affiliate is involved, SoCalGas shall post a notice on its Electronic Bulletin Board, operated in a manner consistent with 18 C.F.R. § 284.10(a), providing the name of the marketing affiliate involved in the discounted transportation transaction, the rate charged, the maximum rate, the time period for which the discount applies, the quantity of gas scheduled to be moved, the receipts points into the SoCalGas system under the transaction, any conditions or requirements applicable to the discount, and the procedures by which a non-affiliated shipper can request a comparable offer. The posting shall remain on the Electronic Bulletin Board for 30 days from the date of the posting. The posting shall conform with the requirements of 18 C.F.R. § 284.10(a). (Remedial Measure 8.)

I. SoCalGas shall file with the CPUC procedures that will enable shippers and the CPUC to determine how SoCalGas is complying with the standards of 18 C.F.R. § 161. (Remedial Measure 9.)

J. SoCalGas shall maintain its books of account and records (as prescribed under Part 201) separately from those of its affiliate. (Remedial Measure 10.)

K. SoCalGas shall maintain a written log of waivers that it grants with respect to tariff provisions that provide for such discretionary waivers and provide the log to any person requesting it within 24 hours of the request. (Remedial Measure 11.)

L. The merged company's Gas Operations[1] shall operate independently and shall be physically separate from Gas Acquisition.[2] (Remedial Measure 12.)

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[1] "Gas Operations" includes the SoCalGas Gas Operations Center at the Spence Street facility and its employees, the SoCalGas Gas Transactions group, and the SDG&E Gas Operations group.

M. Communications pertaining to gas transportation between Gas Operations and any shipper on the SoCalGas system, including Gas Acquisition, shall, except as specifically exempted below, occur on a nondiscriminatory basis, preferably through SoCalGas' interactive GasSelect EBB. The merged company shall not permit any employee or third party to be used as a conduit to avoid enforcement of any of these rules. (Remedial Measure 13.)

N. The SoCalGas GasSelect EBB shall be the primary means of communication between Gas Operations and any shipper on the SoCalGas system, including Gas Acquisition. Telephonic and facsimile communications between Gas Operations and any shipper on the SoCalGas system, including Gas Acquisition, shall be limited to the status and administration of that shipper's transportation and storage capacity, volumes, and, if relevant, expected gas usage. Telephonic communications shall be tape recorded. In addition, SoCalGas shall permit a representative of the CPUC and/or the California Power Exchange to audit or monitor the application of the procedures and protocols being used to operate the system and respond to the service requests of all system users. (Remedial Measure 14.)

O. The merged company shall preclude Gas Operations or Gas Acquisition from learning the financial positions in futures markets of any affiliate. If non-public information of this nature is received by personnel working at Gas Operations or Gas Acquisition, it shall be contemporaneously posted on the GasSelect EBB. (Remedial Measure 15.)

P. Unrestricted communications shall be permitted between Gas Operations and SoCalGas Gas Acquisition to the extent necessary for Gas Acquisition to provide system reliability and balancing services. Such communications shall be posted on the GasSelect EBB no later than seven (7) days after the communication to avoid an artificial increase in the cost of such services that may result from posting this information contemporaneously. (Remedial Measure 16.)

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[2] "Gas Acquisition" means the gas acquisition function at SoCalGas and SDG&E and all energy marketing affiliates unless otherwise stated.

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Required Mitigation Measures
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Q. SoCalGas shall propose to the Commission in the upcoming Gas Industry Restructuring proceeding a set of provisions designed to eliminate the need for SoCalGas Gas Acquisition to provide system balancing. If the system reliability and balancing function is separated from SoCalGas Gas Acquisition, all communications between Gas Operations and SoCalGas Gas Acquisition shall be through, and posted contemporaneously on, the GasSelect EBB, except for the telephonic and facsimile communications addressed above in (3). (Remedial Measure 17.)

R. Any affiliate of SoCalGas (including SDG&E) or of SDG&E shipping gas on the system of SoCalGas, SDG&E, or both for use in electric generation shall use the GasSelect EBB to nominate and schedule such volumes separately from any other volumes that it ships on either system. Such gas will be transported under rates and terms (including rate design) no more favorable than the rates and terms available to similarly-situated non-affiliated shippers for the transportation of gas used in electric generation. (Remedial Measure 18.)

S. SoCalGas shall seek prior Commission approval of any transportation rate discount or rate design offered to any affiliated shipper on the SoCalGas system using existing procedures established by the Commission for review of discounted transportation contracts. (Remedial Measure 19.)

T. SoCalGas shall continue to maintain an EBB that is an interactive same-day reservation and information system. In any case where SoCalGas is required to post information on the Gas Select EBB, it shall post such information within one hour of an executed transaction or the receipt/transmission of any relevant information. (Remedial Measure 20.)

U. SoCalGas shall post daily on the GasSelect EBB the following information for that day: estimated gas receipts by receipt point; necessary minimum flows at each receipt point; estimated system sendout; estimated storage injections and withdrawals; and estimated day-end system underground storage inventory. SoCalGas shall post within one hour the following information: gas receipts by receipt point, and net storage injections and withdrawals. SoCalGas shall also post daily on the GasSelect EBB information depicted in graphic form to show the relationship between storage inventory levels and underdeliveries to the SoCalGas system. (Remedial Measure 21.)

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Required Mitigation Measures
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V. SoCalGas shall post daily the following "next-day" information: capacity available at each receipt point; total confirmed nominations by receipt point; estimated system storage injections and withdrawals; estimated as-available storage capacity; and the status of system balancing rules (daily or monthly). (Remedial Measure 22.)

W. SoCalGas shall post system status data such as maintenance information, facilities out-of-service, expected duration of outage, etc., as soon as such information is known to SoCalGas. (Remedial Measure 23.)

X. SoCalGas shall provide any customer requesting a transportation rate discount an analysis of whether the discount would optimize transportation revenues. (Remedial Measure 24.)

Y. SoCalGas shall provide a transportation rate discount to any shipper on the SoCalGas system if such a discount will optimize transportation revenues, regardless of any impact on affiliate revenues. (Remedial Measure 25.)

End of Appendix A

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