Decision **PROPOSED DECISION OF ALJ WONG** **(Mailed 3/14/2006)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of San Diego Gas & Electric Company (U 902 G) and Southern California Gas Company (U 904 G) for Authority to Integrate Their Gas Transmission Rates, Establish Firm Access Rights, and Provide Off-System Gas Transportation Services.	Application 04-12-004 (Filed December 2, 2004)

(See Appendix B for List of Appearances)

OPINION REGARDING THE SYSTEM INTEGRATION PROPOSAL

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OPINION REGARDING THE SYSTEM INTEGRATION PROPOSAL

I. Summary

This decision addresses the system integration proposal of San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas). The proposal seeks to combine the transmission-related costs of SDG&E and SoCalGas so that customers of each utility share in the transmission costs of both utilities. The combined costs would then be allocated to the customers of SDG&E and SoCalGas to develop the rates shown in Appendix A of this decision. These integrated transmission rates would allow customers of SDG&E and SoCalGas to obtain gas at that rate from any existing or new receipt point on the SDG&E and SoCalGas systems.

In today's decision, we approve the system integration proposal. SDG&E and SoCalGas are permitted to combine the transmission costs of the two utilities, and to develop integrated transmission rates for the various customer classes of both utilities using the cost allocation methodology they proposed. These rates shall go into effect on the first day of the month in which regasified liquefied natural gas (LNG) is expected to flow through Otay Mesa.

II. Background

The application before us was filed in response to the Phase I decision, Decision (D.) 04-09-022, in Rulemaking (R.) 04-01-025. That rulemaking addresses the policies and rules needed to ensure reliable, long-term supplies of natural gas to California. In Phase I of R.04-01-025, SDG&E and SoCalGas advocated for the adoption of their transmission system integration and firm access rights proposals. In D.04-09-022, we declined to adopt those two proposals and directed SDG&E and SoCalGas to file an application regarding

those proposals. D.04-09-022 also designated Otay Mesa as a joint receipt point for the gas transmission systems of both SDG&E and SoCalGas.

SDG&E and SoCalGas filed the above-captioned application in response to D.04-09-022. The utilities propose to integrate the two gas transmission systems on an economic basis, and that their system of firm access rights be adopted. The application also addresses off-system gas deliveries as directed by D.04-09-022.

In the May 24, 2005 scoping memo and ruling (scoping memo), the proposals of SDG&E and SoCalGas were divided into two phases. The first phase addresses the system integration issues. The second phase will address the firm access rights and off-system delivery issues. The phase one system integration issues were identified in the scoping memo as follows:

- Should the gas transmission systems of SDG&E and SoCalGas be integrated on an economic basis, including the transmission component of the gas transportation rates of SDG&E and SoCalGas?
- Does the system integration proposal, including the proposed integration of the gas transmission rates of SDG&E and SoCalGas, conflict in any way with D.01-09-056 and D.98-03-073 regarding the treatment of SDG&E and SoCalGas as separate regulated utilities? (See 79 CPUC2d at pp. 354-355, 429, FOF 146; D.01-09-056, p. 6.)
- Are there any potential capacity constraints along the Rainbow Corridor (Lines 6900, 1027 and 1028), and what impact will this have on the system integration proposal? (See Resolution G-3377.)
- Should the Rainbow Corridor be treated as a local transmission line, backbone transmission line, or as a receipt point, and what impact will this have on the system integration proposal and the ability to move regasified LNG from Otay Mesa? (See Resolution G-3377.)

Three days of evidentiary hearings in the system integration phase of this proceeding were held in September 2005, and this phase was submitted on November 4, 2005, following the filing of reply briefs.

III. System Integration Proposal

A. Introduction

SDG&E is currently a wholesale customer of SoCalGas, and receives all of its natural gas from SoCalGas at the Rainbow and San Onofre meter stations. SDG&E pays a wholesale gas transmission rate to SoCalGas, which contributes to SoCalGas' recovery of its gas transmission revenue requirement. Since SoCalGas customers do not currently use SDG&E's gas transmission facilities, they do not contribute toward SDG&E's recovery of its gas transmission revenue requirement. If regasified LNG is delivered at Otay Mesa, natural gas could flow from SDG&E to SoCalGas.[1]

SDG&E and SoCalGas seek Commission approval of their system integration proposal.[2] The system integration proposal provides the framework for allowing customers of both SoCalGas and SDG&E to access gas supplies flowing into existing or new receipt points, such as Otay Mesa, on both systems at the same transmission rate.[3] Under the system integration proposal, the non-fuel gas transmission costs of the two companies would be combined.[4]

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[1] The Otay Mesa meter station is located in SDG&E's service territory near the border with Mexico.

[2] The parties sometimes refer to the system integration proposal as an "economic integration" of the two systems.

[3] Gas transmission rates would differ by customer class.

[4] The gas transmission systems of SoCalGas and SDG&E are currently integrated on an operational basis. These integrated operations include the monitoring and control of the delivery of gas on both systems, such as the use of a single nomination and scheduling system, as well as planning.

These costs[5] would be allocated to the customers of both utilities to create a uniform transmission rate for all deliveries from SDG&E and SoCalGas receipt points, including Otay Mesa. As a result, the customers of both utilities would have access to receipt points located on either system, and would pay the same integrated transmission rate for gas procured at any of these receipt points. The customers of SoCalGas and SDG&E would continue to pay the separate distribution rates adopted by the Commission for customers in each utility's service territory.

If regasified LNG is delivered at Otay Mesa, this could provide LNG project sponsors in Baja California, and marketers of that gas, with access to the gas demand in SoCalGas' service territory.[6] The average daily demand on the SoCalGas system, net of the SDG&E load, is approximately 2,350 million cubic feet per day (MMcfd), whereas average daily demand on the SDG&E system is approximately 350 MMcfd.

Under the system integration proposal, a customer located on the SoCalGas system would not have to pay a wheeling charge to SDG&E to move gas north from Otay Mesa into SoCalGas' territory. That is, the proposal for a single integrated transmission rate would eliminate the "pancaking" of rates that

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[5] Under the system integration proposal, the combined transmission costs include the transmission capital, operation and maintenance (O&M) costs, and the fuel required to operate the transmission system.

[6] Sempra LNG is the project developer of the Energia Costa Azul (ECA) facility in Baja California. The ECA facility is expected to enter commercial operation in early 2008 with the capability of delivering regasified LNG at the rate of one billion cubic feet per day (Bcfd). Sempra LNG retains 500 MMcfd of gas off-take from the facility, and the remaining 500 MMcfd of gas off-take is owned by Coral Energy Resources, L.P. (Coral).

would result from applying the current SDG&E transmission rate and the SoCalGas transmission rate to transport the gas north from Otay Mesa into SoCalGas' service territory. In addition, under the system integration proposal, SoCalGas' peaking rate would not apply if SDG&E or a customer in SoCalGas' service territory takes gas from Otay Mesa.

Under the system integration proposal, the gas transmission rates for all SoCalGas customers would go up, except for electric generation (EG) customers. For SDG&E customers, gas transmission rates for all customers would decline under the system integration proposal.

B. Rainbow Corridor Issues

In the scoping memo, two issues regarding the Rainbow Corridor were identified. The first is whether there are any potential capacity constraints along the Rainbow Corridor, and the impact this could have on the system integration proposal.[7] The second issue is whether the Rainbow Corridor should be treated as a local transmission line, backbone transmission line, or as a receipt point, and the impact this could have on the system integration proposal and the ability to move regasified LNG from Otay Mesa. These two issues were first identified as issues in Resolution G-3377.

The Rainbow Corridor consists of Lines 6900, 1027 and 1028, which run in a north to south direction from Moreno Station to Rainbow Station. The Rainbow Corridor pipelines are assets of SoCalGas. The Rainbow Station currently functions as a receipt point for virtually all of the natural gas that flows

[7] SDG&E and SoCalGas presented testimony in Phase II of R.04-01-025 describing the proposals to expand capacity along the Rainbow Corridor.

from SoCalGas into SDG&E's territory, and the Rainbow Corridor serves as a local transmission line for SoCalGas to its customers in Riverside County.

The Rainbow Corridor pipelines currently function as local transmission because SoCalGas does not receive any gas from SDG&E. When SoCalGas classified its pipeline system into backbone and local transmission, SDG&E was viewed as being at the terminus of the SoCalGas system at Rainbow Station. Under that model, the pipelines between Moreno and Rainbow Station provide a local transmission function. From SDG&E's perspective, Rainbow Station is viewed as a receipt point into its system.

In Resolution G-3377, we directed SoCalGas to file supplemental testimony in this proceeding "to provide a detailed explanation of potential capacity constraints along the Rainbow Corridor and how the pipeline capacity in the Rainbow Corridor could affect the system integration proposal in that application." The supplemental testimony was to also address "how to integrate the Rainbow Corridor both as a receipt point for SDG&E (with firm tradable rights at that receipt point) as well as local transmission capacity for SoCalGas." (Resolution G-3377, p. 18.)

If the system integration proposal is adopted, and gas flows north from Otay Mesa to SoCalGas through the Rainbow Corridor, the Rainbow Corridor and SDG&E's transmission pipelines would provide a backbone transmission function. The designation of the Rainbow Corridor as a backbone or local transmission function affects the allocation of the pipeline costs.

C. System Integration Proposal and D.01-09-056 and D.98-03-073

Another issue identified in the scoping memo is whether the system integration proposal, including the proposed integration of the gas transmission rates of SDG&E and SoCalGas, conflict in any way with the merger decision that

was adopted in D.98-03-073 (79 CPUC2d 343), and the reorganization decision adopted in D.01-09-056.

In D.98-03-073, we approved the merger between Pacific Enterprises and Enova Corporation.[8] In D.01-09-056, we approved a reorganization of SoCalGas and SDG&E, which further integrated certain operations of the two companies and returned some operations to the utilities.

D. Joint Recommendation

A document entitled Joint Recommendation was attached to the opening briefs of BHP Billiton LNG International, Inc. (BHPB), Coral, Sempra LNG, and The Utility Reform Network (TURN). These four parties recommend that the Joint Recommendation be adopted, which provides as follows:

1. System integration (economic integration of the costs of SoCalGas and SDG&E's transmission facilities, with no 'pancaked' rates) shall be approved in this phase of the proceeding.
2. The adopted cost allocation and rate design methodology for integrated transmission rates shall be placed into effect when Baja LNG supplies begin to flow through the Otay Mesa receipt point. The Commission's determination respecting cost allocation and rate design for integrated transmission rates does not preclude any party from proposing a different cost allocation approach in a future proceeding, except that the parties agree that they will not seek a modification of the determination herein respecting no pancaked rates.
3. Incremental cost allocation shall apply to the first 700 MMcf/day expansion of Otay Mesa takeaway capacity.
4. The Commission's determination on incremental cost allocation as set forth in Paragraph 3 above shall not serve as precedent for the cost allocation approach for any other receipt point and/or backbone

[8] SoCalGas was the principal subsidiary of Pacific Enterprises, and SDG&E was the principal subsidiary of Enova Corporation.

transmission expansion. However, the parties agree that for any new gas supply and/or pipeline connecting with a new or existing receipt point on the SoCalGas/SDG&E system, a scheduling priority comparable to that set forth in Paragraphs 5, 6 and 7 will be established for shippers that advance the funds necessary, on an incremental cost basis, to increase the takeaway capacity at that receipt point.

5. If shipper(s) agrees to and does in fact advance the funds needed to increase the takeaway capacity at Otay Mesa to at least 400 MMcf/day, the shipper(s) shall receive a refund of the advanced funds when gas first flows through the Otay Mesa receipt point, subject to the shipper(s) entering into a 20-year contract that includes scheduling priority rights, as well as a monthly reservation charge equal to the utilities' revenue requirement for the capitalized construction costs based on 20-year amortization of the construction costs and the utilities' authorized rate of return, including depreciation, taxes and fees. The shipper's scheduling priority rights under the 20-year contract will be as set forth in Paragraph 6, and, if the Commission adopts a system of firm access rights, Paragraph 7. The rate treatment regarding a shipper's advanced funds and the scheduling priority rights described in this Paragraph 5 shall also be available at other new or existing receipt points where a shipper advances the incremental costs for increased takeaway capacity at that receipt point.

6. Any shipper that advances the costs of expanding Otay Mesa takeaway capacity in accordance with Paragraph 5 shall receive scheduling priority at Otay Mesa ahead of any other shipper for the receipt point capacity created. In addition, if scheduled flows into SoCalGas' Southern Zone exceed the total capacity available within the Zone (currently 1.2 Bcf), SoCalGas will confirm nominations at the Otay Mesa and Ehrenberg receipt points on a pro rata basis, based upon the Zone's available capacity and the available capacity at each receipt point (Otay Mesa and Ehrenberg). SoCalGas will ensure the scheduling priority at Otay Mesa under this Paragraph 6. The parties agree that issues related to minimum flow requirements, core procurement group set-aside rights, and scheduling protocols on SoCalGas' Southern System will be addressed through the Operational Balancing Agreement and/or through the firm access rights phase of this proceeding.

7. In the event the Commission adopts a system of firm access rights in A.04-12-004 or another proceeding, any shipper that is or has been

awarded scheduling priority in accordance with Paragraphs 5 and 6 hereof shall be awarded firm access rights at Otay Mesa in a manner that maintains its scheduling priority.

8. The scheduling priority at Otay Mesa established herein does not prejudge the Commission's consideration of any firm access rights proposal in a subsequent phase of this or any other proceeding, except that the Commission will not adopt any firm receipt point access approach that diminishes the scheduling priority rights at Otay Mesa adopted herein. This Joint Recommendation does not preclude any party from arguing the merits of whether a system of firm access rights ultimately should be adopted or the terms and conditions of such a firm access rights structure, including the possibility of systemwide access charges as long as such structure does not diminish the scheduling priority at Otay Mesa adopted herein.
9. Shippers awarded scheduling priority in accordance with Paragraphs 5 and 6 will receive scheduling priority to that capacity in exchange for executing the 20-year contract referenced in Paragraph 5 above. Any subsequent shipper that requests additional expanded capacity access and takeaway capacity rights at Otay Mesa will be required to pay the incremental costs for the expanded capacity it has requested, up to a total capacity of 700 MMcf/day, and the shipper shall receive a comparable scheduling priority for the incremental capacity for which it has agreed to pay.

E. Position of the Parties in Favor of the Proposal

In addition to SDG&E and SoCalGas, the system integration proposal is generally supported by Coral, the Division of Ratepayer Advocates (DRA),[9] Duke Energy North America, LLC and Duke Energy Marketing America, LLC (referred to jointly as "Duke"), Sempra LNG, Southern California Generation Coalition (SCGC), TURN, and Woodside Natural Gas Inc. (Woodside).

[9] DRA was formerly known as the Office of Ratepayer Advocates.

1. SDG&E/SoCalGas

SDG&E and SoCalGas assert that the system integration proposal will increase California's access to natural gas supplies by removing barriers that might interfere with natural gas flowing from north to south, or south to north. SDG&E and SoCalGas further assert that the system integration proposal will maximize the benefits of gas-on-gas competition because the gas that flows through Otay Mesa will be able to compete on an equal basis at the same intrastate transportation rate against the other gas supplies competing for customers in the southern California market. If the system integration proposal is not adopted, SDG&E and SoCalGas warn that the regasified LNG from Baja Mexico will flow to east-of-California customers.

SoCalGas and SDG&E also contend that the adoption of the system integration proposal will result in a downward pressure on the price of natural gas, and will lead to increased investment in the gas system infrastructure in both California and Mexico.

In addition, the adoption of the system integration proposal will send appropriate price signals to potential natural gas suppliers to southern California. By adopting an integrated transmission rate, there will no longer be a need for pancaked rates or for an interim transmission rate.

SDG&E and SoCalGas point out that even though many of SoCalGas' customers are located closer to Otay Mesa than to SoCalGas' existing receipt points, under a pancaked rate structure these customers would end up paying two transportation rates for gas received at Otay Mesa. SDG&E and SoCalGas contend that pancaked rates segment the gas market in southern California based on whether the gas is received at a SoCalGas or an SDG&E receipt point, without regard to the miles of transportation involved or the fact that the two

transmission systems are operated on an integrated basis. They contend that the elimination of pancaked rates will help to levelize access costs, instead of driving up the price of LNG supplies from Baja California.

SoCalGas and SDG&E recommend that the cost allocation methodology proposed by SDG&E and SoCalGas be adopted, and that the modifications to the methodology proposed by other parties be rejected. SoCalGas and SDG&E propose to allocate the transmission costs of both systems using the Long Run Marginal Cost (LRMC) allocation methodology adopted in D.00-04-060, which was the latest Biennial Cost Allocation Proceeding (BCAP) for SDG&E and SoCalGas.[10] SoCalGas and SDG&E believe that the Commission should continue the use of the LRMC methodology until the Commission decides in the next BCAP if it wants to change the cost allocation methodology.[11] For non-fuel transmission costs, SoCalGas and SDG&E propose that these costs be allocated on the basis of cold-year throughput. For company-use fuel costs, SoCalGas and SDG&E propose that the combined costs of both utilities be allocated across all customer classes on the basis of average year throughput.

SoCalGas and SDG&E contend that it is premature to use embedded costs for determining the integrated transmission rates. If embedded costs are used to

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[10] SDG&E's transmission costs are currently allocated on cold-year peak month throughput, while SoCalGas' transmission costs are allocated on a cold-year throughput basis. Under the system integration proposal, cold-year throughput will be used to allocate the integrated transmission costs.

[11] In A.03-09-008 and A.03-09-031, SoCalGas and SDG&E proposed that costs be allocated on an embedded cost basis. The Commission dismissed those applications in D.04-05-039 because the gas industry restructuring implementation proceeding was still pending. The witness for SDG&E and SoCalGas testified that they are still considering whether they will propose in the next BCAP to allocate costs based on embedded costs.

allocate transmission costs only, there is likely to be a significant cost shift to noncore customers. SoCalGas and SDG&E believe that before an embedded cost methodology is adopted, the Commission should examine the rate impact and alternatives for mitigating the rate impact, in the next BCAP.

SoCalGas and SDG&E propose that a new regulatory account, the Integrated Transmission Balancing Account (ITBA), be created to balance actual versus adopted transmission revenues for the integrated transmission system. The ITBA is similar to the existing Core Fixed Cost Account (CFCA) and the Noncore Fixed Cost Account (NFCA). They propose that the revenue associated with the transmission rate component be balanced separately from the other revenue components. The difference between the actual transmission revenues and authorized transmission revenues for the two utilities combined would be recorded in the ITBA and amortized in rates the following year. The ITBA balance would then be allocated to all customer classes for the two utilities based on cold-year throughput.

The SDG&E and SoCalGas witnesses testified that if gas is transported from Otay Mesa on the SDG&E system to the SoCalGas system, that would trigger a reclassification of the Rainbow Corridor pipelines from local transmission to backbone transmission, and SDG&E's transmission system would change to a long distance transportation system. However, SDG&E and SoCalGas contend that the classification of the Rainbow Corridor as local or backbone transmission will not affect or change the system integration proposal because a single allocator, based on cold-year throughput, is being proposed for all transmission pipeline costs for the two utilities.

SDG&E and SoCalGas also contend that regardless of whether the Rainbow Corridor pipelines are labeled as backbone or local transmission, it

"will have no operational impact on the ability to receive and transport supply delivered at Otay Mesa under the utilities' system integration proposal." (Ex. 4, p. 8.)

Regarding the issue of whether the system integration proposal is consistent with D.98-03-073 and D.01-09-056, SDG&E and SoCalGas contend that the system integration proposal preserves the separation between the regulated utilities. Each utility will continue to maintain its own corporate identity, publish its own tariffs, and service its own customers. Each utility will continue to own its transmission facilities and no transfer of any assets will take place. Due to this separation, SDG&E and SoCalGas assert that the system integration proposal is consistent with D.98-03-073 and D.01-09-056.

2. Coral

Coral has the right to 500 MMcfd of gas off-take from Sempra LNG's ECA facility in Baja California. This facility is scheduled to begin receiving LNG supplies in December 2007 for testing, and commercial service is scheduled to commence in early 2008.

Coral notes that a substantial portion of its gas supply from the ECA facility could be delivered to the southern California market. Based on Coral's commitments for 300 MMcfd on the Gasoducto Bajanorte (Bajanorte) and North Baja pipelines, Coral could commit up to 200 MMcfd to the southern California market at Otay Mesa. Coral could also deliver a large portion of this gas supply to east-of-California markets or to southern California using the Bajanorte and North Baja pipelines interconnecting with the El Paso Natural Gas pipeline (El Paso) at Ehrenberg. Depending on the Commission's outcome regarding the system integration proposal, that will influence Coral's decision with respect to its firm commitments for pipeline capacity on the Bajanorte and North Baja

pipelines, as well as Coral's willingness to advance the costs for receipt point capacity expansion facilities at Otay Mesa.

Coral asserts that the system integration proposal will encourage new investment, provide ratepayers with enhanced gas-on-gas competition, and improve system reliability. Coral notes that increasing the receipt point capacity and firm takeaway capacity at Otay Mesa will require the expansion of downstream pipelines on the SDG&E system. This additional pipeline capacity on the SDG&E system to accommodate deliveries at Otay Mesa will reduce the need for additional investment to accommodate future load growth on the SDG&E system and in the Rainbow Corridor area. With a single integrated transmission rate, Coral asserts that all the gas suppliers in the southern California market will be able to compete on an equal basis. The adoption of the system integration proposal will also result in improved system reliability because of the additional supply that can flow through Otay Mesa.

Coral acknowledges that in the absence of deliveries of regasified LNG through Otay Mesa, there is no compelling reason for integrating the two systems on an economic basis. However, once SoCalGas' customers are able to access this new supply source over the SDG&E and SoCalGas transmission systems, economic integration of the two gas transmission systems is fully justified because of the gas supply and gas price benefits resulting from deliveries through Otay Mesa.

Coral is willing to advance the cost of expanding the facilities downstream of Otay Mesa, provided that it is able to compete for sales of gas to SoCalGas customers on an equal footing. The downstream expansion will determine the size of the firm Otay Mesa takeaway capacity. Coral asserts that the adoption of

the system integration proposal will send the proper investment signals to shippers of regasified LNG from the ECA facility.

If the system integration proposal is not adopted, Coral contends that the economics of moving gas to Otay Mesa and into SoCalGas' territory may not be justified. The Coral witness testified that the cost to deliver regasified LNG over the Transportadora de Gas Natural de Baja California (TGN) pipeline to Otay Mesa will be virtually identical to the cost to deliver this gas across the Bajanorte and North Baja pipelines to Ehrenberg. The SDG&E/SoCalGas witness calculated that the transmission rate on the SDG&E system could be as high as approximately $0.20 per decatherm (Dth). If such a charge applies to deliver gas through Otay Mesa to SoCalGas' territory, it would make more economic sense for Coral to deliver the gas to Ehrenberg. If the gas is delivered to Ehrenberg, that gas could be delivered either to the SoCalGas market or to the east-of-California market. Depending on the gas price relationships in the southwest U.S. market, it is possible that at certain times of the year, east-of-California customers could bid the gas away from southern California.

Coral asserts that the system integration proposal should be adopted as policy in this proceeding, but the actual implementation of integrated system rates should wait until regasified LNG is delivered at Otay Mesa. Coral believes that the specific rates for the SDG&E and SoCalGas customers can be established here or in a separate proceeding.

Coral recommends that the Joint Recommendation be adopted by the Commission in its entirety. The Joint Recommendation contains the guidelines that are needed to provide upstream suppliers with the regulatory certainty they need regarding the terms and conditions of access to the Otay Mesa receipt point and at other receipt points where new or expanded capacity is constructed. The

Joint Recommendation ensures that the cost allocation and rate design methodology for an integrated transmission system will be implemented by the time regasified LNG begins to flow through Otay Mesa. The Joint Recommendation also provides for incremental cost treatment for the first 700 MMcfd of Otay Mesa receipt point capacity, and provides assurance, without prejudging the firm access rights issues, that if the shippers pay the incremental cost of the facility expansions, they will have priority access to the receipt point capacity that is created.

3. Division of Ratepayer Advocates

DRA recommends that the Commission approve the rate integration of the gas transmission systems of SDG&E and SoCalGas.

DRA recommends that the cost allocation of the combined transmission cost, as well as the proposal to create the ITBA, be deferred until the next BCAP. DRA asserts that the BCAP will provide a better record for determining the cost allocation and related issues, including whether to use LRMC or embedded costs for implementing system integration, and whether to adopt the ITBA. If there is no opportunity to review the cost allocation in a BCAP before regasified LNG flows into Otay Mesa, DRA recommends that SDG&E and SoCalGas be directed to file an application to implement integrated gas transmission rates in 2007 before regasified LNG flows through Otay Mesa.

Although DRA recommends that the cost allocation issues be deferred until the next BCAP, DRA believes the Commission should adopt system integration as a policy now in order to signal to investors and ratepayers that equal access to SDG&E and SoCalGas service territories will be implemented on a timely basis.

DRA also recommends that the Commission approve a phase-in of the new rates in order to moderate the rate impact on SoCalGas customers. DRA contends that the gas transmission rates for SoCalGas customers make up only a small portion of the price of delivered gas, and that the slight increase resulting from economic system integration is a reasonable trade off for access to increased gas supplies.

DRA contends that even if SoCalGas customers do not purchase the regasified LNG delivered at Otay Mesa, these additional supplies are likely to exert a downward pressure on prices because the price of regasified LNG delivered at Otay Mesa is expected to be lower than the price of gas that currently sets the market clearing price for SoCalGas. DRA also asserts that system integration may reduce some operational costs by allowing customers to be served by gas from closer receipt points.

DRA contends that the proposed economic system integration appears to be consistent with D.98-03-073 and D.01-09-056. Although the system integration proposal creates joint receipt points for gas deliveries, SDG&E and SoCalGas remain as separate legal entities with their own service territories and customers, and separate distribution rates for the customers of each utility.

4. Duke

Duke supports the system integration proposal and views it as a logical consequence of the merger of these companies' parents. Duke contends that the two systems have been operated in an integrated fashion for many years, and the proposal helps to bring rates in line with this operational reality.

Duke asserts that TURN's recommendation to allocate costs based on an embedded cost basis should be rejected for three reasons. First, the use of LRMC produces more economically efficient price signals. Second, PG&E's

transmission rates were set in the Gas Accord settlement, and subsequent renewals, in which the interests of many parties were resolved on a number of different issues. If embedded costs are used, there will be a significant cost shift to noncore customers, which runs counter to efficient pricing. Third, TURN's arguments about the possible effects of changes in distribution or customer-related marginal costs on transmission rates are not persuasive because some level of rate change is normal as costs change. For those reasons, Duke recommends that LRMC be retained as the basis for ratemaking.

5. Sempra LNG

Sempra LNG supports the system integration proposal of SDG&E and SoCalGas. Sempra LNG asserts that the proposal will result in significant customer benefits by encouraging new supplies, including regasified LNG, to enter the southern California market, which will result in a downward pressure on natural gas prices. The system integration proposal promotes gas-on-gas competition by equalizing the cost of intrastate transmission across southern California, and achieves the nondiscriminatory open access policy that the Commission ordered in D.04-09-022. Sempra LNG asserts that in order to send the right signal to upstream developers of LNG supplies and to the investment community, the system integration proposal should be adopted.

Sempra LNG asserts that the record contains sufficient evidence that the commodity price benefits of LNG will more than offset the relatively minor impact on SoCalGas' intrastate transmission rates. Sempra LNG contends that the new sources of gas supply will reduce gas prices and price volatility, as compared to market conditions in which gas supplies are relatively short or scarce.

Sempra LNG also points out that under system integration, gas supplies delivered at Otay Mesa for a SoCalGas customer located in Temecula, would travel less distance than if the gas supplies were delivered at Ehrenberg, South Needles or North Needles. Sempra LNG asserts that it makes no sense for such a customer to pay a higher rate for deliveries that travel less distance, and more for deliveries that travel a shorter distance. System integration prevents this inequitable situation from developing.

Sempra LNG also contends that the adoption of the proposal will have other benefits as well. System integration will enhance system and supply reliability by providing access to diverse gas supplies. The proposal will also encourage the development of the natural gas infrastructure in Baja California, as well as in southern California, all of which will benefit California.

As to when the new integrated transmission rates should go into effect, Sempra LNG favors deferring the rate changes until gas deliveries at Otay Mesa commence. This will allow the Commission to implement these small transmission rate increases at the same time that rate decreases should result from lower commodity prices.

Sempra LNG states that the Joint Recommendation reflects the efforts of a variety of parties over the last several months, and embodies two core principles. The first principle is support for system integration, and the second principle is support for the concept that if a shipper pays incremental rates to expand receipt point takeaway capacity, the shipper should receive a priority right to use that capacity.

The Joint Recommendation also recommends that the integrated rates go into effect when LNG supplies from Baja begin to flow through the Otay Mesa

receipt point. Until the new rates go into effect, the Joint Recommendation proposes that the interim rates described in D.04-09-022 continue.

6. SCGC

SCGC supports the system integration of the SDG&E and SoCalGas transmission systems. The system integration proposal will result in postage stamp transmission rates on a Sempra-wide basis, which will promote gas-on-gas competition in southern California among new and existing suppliers regardless of the delivery point. SCGC notes that the proposal is consistent with D.04-09-022, wherein the Commission recognized the importance of ensuring access to supplies of natural gas and increasing the diversity of interstate supplies.

According to SCGC, if the system integration proposal is not adopted, a customer located on the SoCalGas system would pay significantly greater transportation costs for gas received through Otay Mesa than for gas received from sources that deliver directly into the SoCalGas system. A customer located on the SDG&E system would incur considerably lower transportation costs for gas supply received through Otay Mesa than for gas supply received from sources that deliver into the SoCalGas system. SCGC contends that such a result prevents the various supply sources from competing on an equal footing, and does not promote gas-on-gas competition.

SCGC supports DRA's proposal for a three-step phase-in of the new rates, beginning in January 1, 2006, or as soon thereafter as possible, another on January 1, 2007, and the final phase-in on January 1, 2008. If the Commission does not adopt a phase-in approach, SCGC recommends that system integration be fully implemented no later than January 1, 2008 so that the system integration will be in place by the time the first LNG supplies arrive in California.

SCGC opposes the suggestion of some of the parties that the implementation of system integration occur after the next SDG&E and SoCalGas BCAP. SCGC points out that no BCAP is currently scheduled, and if a decision on the BCAP is not adopted until after the LNG supplies enter Otay Mesa, there will be a loss in the benefits from gas-on-gas competition during this period.

SCGC opposes the proposal to implement an ITBA for transmission-related costs for three reasons. First, SCGC contends there is no need for the ITBA because each utility already has a CFCA and a NFCA. These accounts record actual and authorized transportation revenues, including transmission-related revenues, for core and noncore customers. Any over-recovery or under-recovery is recovered in the annual January 1 rate adjustments for core and noncore customers.

Second, the proposed ITBA would permanently provide 100% balancing account treatment for all transmission-related revenues recorded in the ITBA, which would insulate the utilities against any throughput risk for the recovery of their integrated transmission revenue requirement. SCGC contends that the 100% balancing account protection for costs recorded in the NFCA is supposed to be on an interim basis until the new BCAP rates go into effect. SCGC asserts that this proposed change is beyond the scope of this phase of the proceeding.

Third, SCGC asserts that the ITBA will shift revenues between SoCalGas and SDG&E and among customer classes. Instead of determining account balances separately for SDG&E core and noncore classes and SoCalGas core and noncore classes by balancing the revenue requirement allocated to each class against the revenues received from each class, the Sempra-wide transmission revenue requirement would be balanced against Sempra-wide transmission

revenues, with the resulting over-collection or under-collection allocated to all customer classes for the two utilities based on cold-year throughput.

7. TURN

TURN contends that integrating the transmission rates of SDG&E and SoCalGas makes a certain degree of sense once gas flows into the system at Otay Mesa. Without system integration, the cost of delivering LNG from Baja California would be higher by the amount of the transportation cost across the SDG&E system. However, TURN notes that the system integration proposal provides an undue competitive advantage to Sempra LNG's ECA project, relative to other potential LNG projects.

TURN's witness recommends that any integrated transmission service should be priced at embedded costs, rather than on a LRMC basis. TURN favors the embedded cost methodology because it is consistent with how Pacific Gas and Electric Company (PG&E) prices transmission service on its system. In addition, the embedded cost method preserves the principle that the distribution rates of SDG&E and SoCalGas should remain separate.

TURN contends that the proposed rate changes resulting from the system integration proposal should not go into effect until gas begins to flow into Otay Mesa. TURN believes that the actual receipt of gas at Otay Mesa should be the triggering event for system integration because that event will fundamentally change the nature of the gas flows on the system.

TURN proposes that the Commission make the approval of the system integration proposal contingent on a commitment by the utilities to refrain from proposing or supporting rolled-in rate treatment of the costs related to the potential capacity expansion at the Otay Mesa receipt point. Instead, the costs of

expanding the receipt capacity at Otay Mesa should be charged on an incremental basis to the shippers that flow gas through that receipt point.

TURN contends that the Joint Recommendation establishes a rational and effective policy for providing access to the California market to potential suppliers of LNG on reasonable terms, without placing an inappropriate burden on captive ratepayers. The Joint Recommendation allows for the economic integration of the transmission rates of SDG&E and SoCalGas, subject to incremental ratemaking for the costs of expanding the take-away capacity at Otay Mesa up to at least 700 MMcfd. In return for agreeing to pay the incremental costs of expanding system receipt point and take-away capacity, shippers would receive scheduling priority for the capacity that they paid to create.[12] TURN asserts that this tradeoff effectively mitigates the undue competitive advantage that system integration would otherwise create.

8. Woodside

As a potential supplier of regasified LNG to California, Woodside supports policies that allow all suppliers to compete on an equal basis. Woodside believes that the system integration proposal has the potential to promote gas-on-gas competition, if system integration is implemented as part of a consistent, broader policy of promoting such competition. Woodside asserts that the adoption of policies that favor existing suppliers over new suppliers will undermine gas-on-gas competition.

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[12] TURN also points out that the incremental cost approach will result in the least cost expansion of the transmission system because the shippers who bear the costs will determine which facilities to fund, and ratepayers will not have to pay the costs.

Woodside contends that if the Commission approves the system integration proposal based on the potential to promote gas-on-gas competition, then that same policy should be carried over to other proceedings and other phases of this proceeding. That is, existing suppliers should have no more (or less) of a competitive advantage than new suppliers of natural gas.

Woodside recommends that the Joint Recommendation be rejected because it was introduced in the opening briefs of the parties who advocate its adoption. None of the other parties had an opportunity during the hearings to evaluate the Joint Recommendation. The Joint Recommendation seeks to influence and address the firm access rights issue by proposing the adoption of scheduling priority rights at Otay Mesa. The Joint Recommendation also contemplates that gas suppliers will pay for the expansion of takeaway capacity at Otay Mesa. Since firm access rights are not supposed to be addressed until after the system integration issues are resolved, and because the Joint Recommendation is unclear about what type of capacity is being referred to, Woodside recommends that the Joint Recommendation be rejected at this time.

Woodside points out that there is ample testimony in the record about the risks and benefits of the system integration proposal. Woodside contends that the system integration proposal should be addressed on its merits and without reference to the Joint Recommendation.

F. Position of the Parties Opposed to the Proposal

The parties who oppose the system integration proposal are the Indicated Producers, Watson Cogeneration Company, and the California Manufacturers and Technology Association (collectively referred to as "IP/Watson/CMTA"); BHPB; Crystal Energy LLC (Crystal); and Southern California Edison Company (SCE).

1. IP/Watson/CMTA

IP/Watson/CMTA oppose the system integration proposal because it results in a direct ratepayer subsidy of the LNG affiliate of SDG&E and SoCalGas. The only reason why system integration is being proposed is because of the anticipated entry of LNG from Baja California into the southern California market through the Otay Mesa receipt point. According to IP/Watson/CMTA, the subsidy will result from the roll-in of the transportation costs from Otay Mesa to Rainbow Station into end user rates. In the absence of system integration, the transportation costs from Otay Mesa to Rainbow Station would be paid incrementally by either shippers who want to bring LNG from Baja California into SoCalGas' service territory, or by the end-use customers purchasing this gas.[13] IP/Watson/CMTA contend that there is no justification for providing more favorable rate treatment to LNG suppliers who bring gas from Baja California into Otay Mesa.

This rate subsidy is objectionable to IP/Watson/CMTA for several reasons. First, although D.04-09-022 states that the Commission might permit the roll-in of costs in individual cases if the benefits can be demonstrated to outweigh the costs, no such cost-benefit analysis was done in this proceeding. Second, the rate impact on the system integration proposal is disproportionate in that it clearly shifts costs from core customers to noncore customers, and from SDG&E customers to SoCalGas customers. Third, a customer who chooses to

[13] IP/Watson/CMTA note that an example of this approach is that which is used to bring Canadian gas into the southern California market over the PG&E system. In that case, the supplier or the customer must bear the "pancaked" or incremental costs of transporting the gas on the PG&E system upstream of the SoCalGas citygate.

continue purchasing from an existing receipt point will end up subsidizing the transportation of regasified LNG from Otay Mesa to SoCalGas' system for a customer who chooses to purchase Baja California supplies. And fourth, under the system integration proposal, SoCalGas' peaking rate would not apply to customers who elect to be served through Otay Mesa, but other customers who seek to connect to new or alternative supply sources would not be exempt from the peaking rate. IP/Watson/CMTA contend that this results in a discriminatory waiver of the peaking service tariff.

IP/Watson/CMTA assert that the system integration proposal is premised on the assumption that system integration will maximize the benefits of gas-on-gas competition and result in lower prices. IP/Watson/CMTA contend that the record lacks evidence that cost benefits will result from the system integration proposal. Even if the Commission accepts the premise that benefits from gas-on-gas competition will accrue to SoCalGas customers as a result of the entry of regasified LNG at Otay Mesa, they point out that the same benefits will occur at other LNG entry points. In addition, the price benefit at these other locations will occur without additional transmission rate burdens.

IP/Watson/CMTA further contend that the entry of regasified LNG from Baja California through Otay Mesa is far from certain because no LNG terminal in Baja California has been completed yet. Even if the terminal is built, there is no guarantee that the gas will flow into the southern California market through Otay Mesa in significant volumes. They note that the majority of flowing gas could be consumed in Mexico instead of the United States. Even if the gas flows through Otay Mesa, there is no way of estimating how much of that gas will reach the SoCalGas system, or whether the volumes serving SoCalGas customers would even be material. The regasified LNG could also enter the SoCalGas

system at Blythe, instead of through the SDG&E system, if the gas flows over the Bajanorte and North Baja pipelines.

Due to the uncertainty of how much LNG will reach the southern California market, IP/Watson/CMTA recommend that the Commission not adopt the system integration proposal until material volumes of regasified LNG begin to flow through Otay Mesa. To do otherwise will result in a rate increase to SoCalGas customers without any counter-balancing benefits.

IP/Watson/CMTA also oppose the system integration proposal because of the cost shift and rate impacts on SoCalGas customers. Under the system integration proposal, SDG&E customers will receive a rate reduction of 1.8 to 2.6 cents per therm, or 18 to 26 cents per Dth. According to IP/Watson/CMTA, the rate decreases for SDG&E customers translate into a range as high as 23% of the customer's total transportation charge. SDG&E customers will have the same rights and service as SoCalGas customers, and could access greater volumes of LNG.

In contrast, SoCalGas customers, with the exception of EG customers, will experience a rate increase of 0.2 to 0.4 cents per therm, or 2 to 4 cents per Dth. Although SoCalGas customers would have a right to use Otay Mesa as a receipt point, it is uncertain to what extent SoCalGas customers will be able to exercise those rights because there is no system of firm access rights in place. IP/Watson/CMTA also point to the significant capacity constraints of moving gas north into the SoCalGas system once 400 MMcf/d flows through Otay Mesa. Also, the regasified LNG may move east to enter SoCalGas' system at Blythe or be sold into other markets.

If the Commission decides to adopt the system integration proposal, IP/Watson/CMTA recommend that certain mitigating modifications be

adopted. Instead of adopting an integrated postage stamp rate, they recommend that the interim rate established in D.04-09-022 be retained. With the interim rate, customers within a particular utility's service territory would pay the applicable utility rate but receive access to the entire SoCalGas and SDG&E transmission systems. In the future, if SDG&E and SoCalGas can demonstrate that the benefits of Otay Mesa far outweigh the costs, the Commission could consider the roll-in of those costs and the adoption of a system-wide Otay Mesa surcharge for all SDG&E and SoCalGas customers on an equal cents per therm basis.

As an alternative mitigation measure, the proposed cold-year throughput allocation factor should be rejected, and a blended peak month/cold-year throughput factor should be used instead.[14]

IP/Watson/CMTA also recommend that the Commission make clear that the waiver of the peaking rate for SDG&E customers, without a similar waiver for other customers, constitutes undue discrimination.

2. BHPB

If the Joint Recommendation is not adopted, BHPB recommends that the system integration proposal be rejected without prejudice. BHPB asserts that the system integration proposal only benefits LNG entering Otay Mesa from Baja California, and the affiliate of SDG&E and SoCalGas.

BHPB contends that the proposal is based on hypothetical benefits, unproven physical operations, and insufficient analysis and information to

[14] IP/Watson/CMTA propose that the costs be allocated 47% on the basis of cold-year peak month throughput, and 53% on the basis of cold-year throughput.

develop the proposed rates. BHPB contends there has been no effort to quantify the benefits associated with gas-on-gas competition to support the integration of the two systems.

BHPB asserts that the proposed rate structure is likely to burden commercial and industrial customers of SoCalGas. The evidence establishes that all customers on the SDG&E system will see a significant rate reduction, while SoCalGas customers will see a rate increase. According to BHPB, most of the rate increase will be incurred by commercial and industrial customers, who will end up subsidizing the delivery of LNG from Baja California into the SDG&E system at a subsidy of about 20 cents per Dth. However, these noncore customers of SoCalGas will have no assurance of access to the Otay Mesa receipt point or the supplies that purportedly will flow through there.

BHPB also asserts that the system integration proposal is premised on the assumption that significant quantities of natural gas will flow through Otay Mesa from Baja California, and that significant volumes of this gas will physically flow into the SoCalGas system. However, BHPB contends that the testimony reflects that at least 50% of the supplies are dedicated to the market within Mexico, and the remaining 50% of the supplies will diminish and will be unavailable to the California market within a decade. BHPB also asserts that the completion of the ECA LNG terminal is uncertain because of pending litigation, and it is unclear whether the LNG will flow into SoCalGas' system through Blythe or through Otay Mesa. In addition, BHPB asserts that the actual costs of any facility additions on the SDG&E and SoCalGas systems are still uncertain, and according to the witness for SDG&E and SoCalGas, all of the cost estimates should be escalated by 30%.

Under the proposal, the rate increase would go into effect before any volumes flow or even if no volume flows. BHPB believes that the implementation of system integration should be deferred at least until regasified LNG deliveries commence.

BHPB believes that the principles set forth in the Joint Recommendation represent the least objectionable compromise of the issues at this time, and recommends that the Joint Recommendation be adopted. In the event the Joint Recommendation is not adopted, BHPB urges the Commission to adopt BHPB's litigation position.

BHPB asserts that in the merger decision, the Commission precluded SoCalGas and SDG&E from operating in a manner that results in post-merger cost shifts and rate subsidization. If the system integration proposal is adopted, there will be a cost shift to SoCalGas' customers and a rate reduction for SDG&E customers. BHPB contends that this cost shift needs to be considered as part of the Commission's decision.

3. Crystal

Crystal recommends that the proposal to integrate the gas transmission rates of the two systems be rejected. Crystal asserts that the proposal will result in cross-subsidies, and if LNG supplies from Baja California do not flow in large quantities from Otay Mesa to SoCalGas customers, the rate integration will result in higher gas transmission rates for customers of SoCalGas. If the system integration proposal is adopted, and SDG&E's customers receive LNG from Otay Mesa and SoCalGas customers receive LNG from California LNG suppliers, Crystal asserts that the proposed rate integration will not reflect actual transmission system operations. According to Crystal, the system integration

proposal provides a competitive advantage to Sempra LNG relative to other LNG projects that deliver their supplies directly into the SoCalGas system.

Crystal contends that the existing rate structure provides access to all LNG project receipt points in each of the utility service areas without cross-subsidies. Under the existing regulatory framework, SDG&E and SoCalGas customers will have access to California-based LNG supplies at receipt points that connect directly to the SoCalGas system. LNG supplies from Baja California can supply the smaller SDG&E market through the Otay Mesa receipt point, and SoCalGas customers can access these supplies at the existing Blythe receipt point.

Crystal contends that SDG&E and SoCalGas bear the burden of proof regarding the system integration proposal, and there must be clear and convincing evidence that the proposed rate change is both just and reasonable. Crystal contends that SDG&E and SoCalGas failed to meet their burden of proof and only offered speculation that the integrated rate will attract new LNG supplies which may increase price competition and result in lower commodity prices. Crystal asserts that the same benefits will occur with the other proposed LNG projects and is not limited to the Baja California LNG projects.

Crystal contends that it is an unrefuted fact that if Baja supplies through Otay Mesa do not exceed 500 MMcfd to SoCalGas customers, the rate integration will result in higher transportation rates to SoCalGas customers without any benefits. Crystal asserts that the likelihood is low that SoCalGas' customers will purchase large volumes of gas supplies at Otay Mesa because of the potential that the regasified LNG from Baja California can serve a very large market outside of California, as well as in San Diego. This probability will be even lower if one or more of the other LNG competitors interconnect directly to the SoCalGas system. Although SDG&E/SoCalGas seek the guarantee of integrated

rates, Crystal argues the proponents of LNG from Baja California are unwilling to guarantee that the volumes necessary to justify the rate increase will be sold to SoCalGas customers. According to Coral's own witness, the amount of gas to be delivered into California depends on the gas quality standard and what rights a shipper will have to the pipeline capacity.

In deciding whether the system integration proposal should be adopted or not, Crystal contends the Commission must also consider the cost of the improvements to develop or expand the receipt point capacity in order to obtain access to the new supplies. The estimate of the cost to expand the Otay Mesa receipt point to receive large volumes, such as 800 MMcfd, are dramatically higher than for the receipt points associated with other possible sources of LNG supplies. Crystal contends the relatively high cost of expanding the receipt capacity at Otay Mesa should be considered before the Commission decides to adopt a rate structure that is dependent on large volumes of deliveries at this location.

Crystal contends that the system integration proposal will lower the cost of transportation at the receipt point of the affiliate of SDG&E and SoCalGas, and will raise the cost of transportation at the receipt points of its California LNG competitors. According to Crystal, this action is a significant test of the regulatory oversight that was promised in D.98-03-073, the merger decision.

4. SCE

SCE recommends that the system integration proposal be rejected because there will be a cost shift from SDG&E customers to SoCalGas customers, there is a lack of benefits to SoCalGas customers, and the direct beneficiary of the system integration proposal is Sempra LNG, an affiliate of SDG&E and SoCalGas.

SCE asserts that the system integration proposal should be rejected because it will reverse the progress toward cost-based transportation rates for customers. According to SCE, the use of pancaked rates is appropriate because the transportation systems of both SDG&E and SoCalGas will be used to transport the regasified LNG from Otay Mesa into SoCalGas' territory. SCE asserts that under properly designed rates, the customers of one system should fairly compensate customers of the other system for the use of the system.

SCE contends that a single postage stamp rate is not appropriate for both transmission systems. A postage stamp rate is appropriate when it is not possible or practical to define the costs of a system on a "miles of haul" basis or some other distance related allocation formula. SCE asserts that the costs of bringing gas from Otay Mesa across the SDG&E system into the SoCalGas system are easily identifiable and quantifiable. By integrating the costs of the two transmission systems, this will cause one set of customers, those who do not cause the costs on the system, to subsidize another. SCE asserts that when there are cross-subsidies, this results in false price signals and uneconomic decisions on the part of customers.

SCE contends that the system integration proposal does not have to be adopted in order for the regasified LNG from the ECA facility to flow to SDG&E or to SoCalGas customers. The regasified LNG can be delivered to SoCalGas customers from Otay Mesa by paying pancaked rates, i.e., a transportation charge to SDG&E to cover the cost of transporting gas from Otay Mesa through the SDG&E system, and a transportation charge to SoCalGas to cover the cost of transporting gas through the SoCalGas system. Alternatively, regasified LNG from the ECA facility can be delivered into SoCalGas' service territory at the point of interconnection with El Paso at Ehrenberg via the Bajanorte and North

Baja pipelines. In light of the alternatives, SCE contends that the system integration proposal should be rejected as unnecessary and imprudent.

SCE also contends that it is unclear if Coral will even deliver regasified LNG through Otay Mesa. Even though the ECA facility will have the capability of delivering regasified LNG at the rate of 1 Bcfd, 500 MMcfd of that gas is to be consumed in Mexico. Of the remaining 500 MMcfd, Coral has committed 300 MMcfd of its share to flow to Ehrenberg over the Bajanorte and North Baja pipelines. Assuming this 300 MMcfd of capacity is fully used, that leaves only 200 MMcfd flowing at Otay Mesa. Of the 200 MMcfd, SCE asserts that only 50 MMcfd will flow through Otay Mesa to SoCalGas' service territory, and the rest will go to SDG&E customers.

SCE also asserts that the uncertainty of how much gas will flow to SoCalGas is magnified by the testimony of Coral's own witness, who stated that three issues need to be resolved before Coral invests the monies to expand the capacity at Otay Mesa. The first is what the terms of access to the system will be. The second is if funds are used to expand capacity, Coral needs to know whether they will have rights to use the expanded facilities. And third, the gas quality standards need to be clarified. With all these uncertainties about how much of the regasified LNG will actually flow through Otay Mesa, SCE believes the Commission should question the wisdom of restructuring the transportation rates which will result in higher rates for customers of SoCalGas.

SCE points out that to accommodate any increase in LNG from Mexico, either Otay Mesa or the interconnection with El Paso could be expanded. SCE agrees with TURN that SDG&E and SoCalGas should be required to expand future access to its proposed Southern Transmission Zone on a least cost basis.

According to TURN's testimony, it would be cheaper to expand capacity at Blythe, rather than to expand Otay Mesa beyond the initial 200 MMcfd.

SCE contends that the Commission does not need to adopt the system integration proposal in order to promote gas-on-gas competition. This competition will develop if Crystal's Clearwater Port project in Ventura and the BHPB project in Long Beach are built. Both of these facilities, if approved, are expected to be completed within one year of the ECA facility. In addition, if regasified LNG from Baja California enters the SoCalGas system at Blythe, the benefit of gas-on-gas competition will occur even if there is no system integration.

SCE contends it is inequitable for SoCalGas customers to have to pay higher rates for the benefit of gas-on-gas competition when all customers in the southwest United States will benefit from this new supply source. It is also inequitable that SDG&E customers will receive the benefit of gas-on-gas competition while being subsidized by the system integrated rates.

As a result of system integration, Sempra LNG will have an advantage over other potential LNG projects which seek to deliver directly into the SoCalGas system. SCE asserts that without system integration, the cost of delivering LNG through Otay Mesa into the SoCalGas system will be higher by the amount of the transportation cost across the SDG&E system.

SCE contends the merger decision, D.98-03-073, permits some economies of scale between SDG&E and SoCalGas, but it does not permit a merging of the services of the two utilities when there is an elimination of separate rates and separate ratemaking. D.98-03-073 was intended to mitigate anti-competitive effects and to prevent cross subsidies. SCE also contends that the shared

transmission system violates the concept of stand alone distribution companies in D.98-08-073.

SCE contends the adoption of the system integration proposal would violate the requirement in D.98-03-073 that SDG&E and SoCalGas be treated as separate regulated utilities. If a uniform, system-wide rate is adopted, the required line of separation between the two utilities will be blurred. By combining their prices and creating a cross-subsidy, the utilities will no longer be independent in the area of rates.

If the system integration proposal is adopted by the Commission, SCE asserts that the implementation of the rates should only occur when the gas flows from Otay Mesa. SCE also asserts that because the integrated rates that SDG&E and SoCalGas developed are based on outdated LRMC from the BCAP in 1999, the transportation rates should be set in the BCAP where current conditions can be used as the basis for the rates.

G. Discussion - System Integration Proposal

1. Introduction

At present, the gas transmission systems of SDG&E and SoCalGas are operated on an integrated basis. These integrated operations include the monitoring and control of the delivery of gas on the two systems, as well as a single nomination and scheduling system. Under current operations, the transmission and distribution costs of the two utilities remain separate.

Under the system integration proposal, the transmission costs of both systems would be combined and integrated transmission rates would apply to each customer class of both utilities. Under the proposal, the transmission rates of SoCalGas customers will increase, in general, from 0.2 to 0.4 cents per therm, while the transmission rates of SDG&E customers would decrease by

approximately 1.8 to 2.6 cents per therm.[15] Under the system integration proposal, a customer of either SDG&E or SoCalGas will be able to obtain gas from any receipt point on either system at the single integrated transmission rate.

At the present time, all of the natural gas that flows into SDG&E's service territory comes over the SoCalGas transmission system. If regasified LNG from Baja California flows through Otay Mesa, this gas could serve SDG&E's customers, and to SoCalGas' customers through the use of the SDG&E system and the Rainbow Corridor. Alternatively, the regasified LNG from Baja California could be delivered into the SoCalGas system at Blythe through the use of the Bajanorte, North Baja, and El Paso pipelines. Currently, none of the gas delivered to an end-use customer in SoCalGas' service territory comes from a receipt point on SDG&E's system.

In deciding whether the system integration proposal should be adopted, we need to analyze the various benefits and drawbacks that the parties have raised concerning the proposal. These considerations consist of the following, and are discussed in detail below:

(1) subsidy and rate impact
(2) LNG gas volume
(3) gas price
(4) infrastructure investment
(5) pancaked rates
(6) peaking rate
(7) allocation methodology
(8) ITBA
(9) Rainbow Corridor

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[15] Tables 1 and 2 of Attachment 1 to Exhibit 9 show the rate impact on SDG&E and SoCalGas customers as a result of system integration. Those two tables are attached to this decision as Appendix A.

(10) merger and reorganization decisions
(11) Joint Recommendation

2. Subsidy and Rate Impact Considerations

The parties who oppose the system integration proposal assert that the proposal will result in a cross-subsidy of Sempra LNG, SoCalGas customers will end up subsidizing SDG&E customers, the proposal provides a competitive advantage to Sempra LNG over other California LNG projects, and the rates of SoCalGas customers will go up unnecessarily.

The parties contend the proposal will result in a cross-subsidy of Sempra LNG, which is an affiliate of SDG&E and SoCalGas. The cross-subsidy will occur through the integration of the two transmission rates, which will result in a cost shift from customers of SDG&E to SoCalGas. This cost shift to SoCalGas customers will allow Sempra LNG, as well as Coral, to access the SDG&E and SoCalGas transmission systems at a single integrated rate throughout southern California. The single integrated rate will allow Sempra LNG and Coral to deliver their regasified LNG to Otay Mesa, and through the Rainbow Corridor into SoCalGas' service territory, without the pancaking of two transmission rates. Under the system integration proposal, SoCalGas' peaking rate would not apply if a SoCalGas customer takes gas from Otay Mesa.

According to the opponents of the system integration proposal, customers of SoCalGas will end up subsidizing SDG&E customers because the rates of SDG&E customers will decrease, and the rates of SoCalGas customers will increase. The rate impact of this cost shift to SoCalGas customers amounts to approximately $14.4 million.

The opponents of system integration also assert that Sempra LNG's ECA project will gain a competitive advantage over other LNG projects that are being

proposed for southern California, because the single integrated rate, rather than pancaked rates, will apply when gas is transported from Otay Mesa into SoCalGas' service territory. The integrated rate reduces the cost of regasified LNG flowing through Otay Mesa.

The parties who favor the adoption of the system integration proposal assert that the system integration proposal will result in benefits to all natural gas customers in southern California, because the LNG from Baja California will result in a new source of gas supply which will increase gas supply reliability and diversity of supply, and result in gas-on-gas competition. The proposal will also allow all gas customers in southern California to equally access gas supplies from new and existing receipt points at a single integrated rate. The proposal will also reduce operating costs by lowering compression costs. They also contend the system integration proposal is consistent with the goals contained in the Energy Action Plan. The parties in favor of the proposal also point out that the rate increase to SoCalGas customers is a minor component of the overall price of gas, and is outweighed by the benefits that will result from the system integration proposal.

We first address the contention that the system integration proposal will result in SoCalGas customers subsidizing an affiliate, and provide the affiliate with a competitive advantage. This contention is based in part on the current status of the gas transmission systems of SDG&E and SoCalGas, which has two separate transmission rates and all of the natural gas needs of SDG&E are met through receipt points on the SoCalGas system. Otay Mesa is the closest interconnection of SDG&E to the ECA facility. With one exception, natural gas has not been delivered into SDG&E's system from a SDG&E receipt point. With the construction of the ECA facility in Baja California, Sempra LNG's project has

the potential to change the directional flow of gas on the two gas transmission systems by delivering regasified LNG through Otay Mesa to serve some or all of SDG&E's load, and through the SDG&E system and the Rainbow Corridor to serve some of the gas load of SoCalGas customers.

Depending on the amount of gas that is delivered through Otay Mesa and the infrastructure investments that are made, this new gas supply source can be used to serve some or all of SDG&E's load and a portion of SoCalGas' load. This potential change in the direction of the flow of gas is the impetus for the system integration proposal. Instead of SDG&E taking all of its gas from SoCalGas receipt points, SDG&E can access gas supplies through Otay Mesa.

The entry of regasified LNG at Otay Mesa raises the issue of the rate that SDG&E customers should have to pay to transport this gas. Under the current structure, SDG&E is a wholesale gas customer of SoCalGas. If a SoCalGas customer were to obtain gas from Otay Mesa, and the system integration proposal is not adopted, that customer would have to pay the pancaked rates of SDG&E and SoCalGas. Under the system integration proposal, the SDG&E customer and the SoCalGas customer would only pay the single integrated rate to access gas from Otay Mesa. If the system integration proposal is not adopted, and SDG&E takes gas from Otay Mesa, SoCalGas' peaking rate tariff might apply as well.

The ECA facility of Sempra LNG is currently being built in Baja California, and is likely to be the first LNG project on the west coast. Due to the construction progress of the ECA project and its proximity to Otay Mesa, the Commission has a window of opportunity to decide whether to encourage the entry of LNG into California to help meet the gas needs in southern California or to take a wait and see approach as to whether the California-based LNG projects

will be approved or not. If we decide to await the approval status of the other LNG projects proposed for California, we will forgo this window of opportunity of providing regulatory certainty to Sempra LNG and Coral concerning the delivery of LNG from Baja California into the Otay Mesa receipt point. If we reject or defer the system integration proposal, that will send a negative price signal to Sempra LNG and to Coral, and may result in the loss of Baja California LNG as a supply source. Instead of sending that gas into southern California and making the needed investments, Sempra LNG and Coral may decide that it is more economic to market the gas to east-of-California customers by shipping the gas through the Bajanorte and North Baja pipelines to the interconnection with El Paso. It is in California's best interest to take steps now to encourage suppliers to deliver that gas to the southern California market instead of to east-of-California markets.

The ECA facility offers a new supply opportunity for gas customers in southern California. That facility can deliver 1 Bcfd of regasified LNG, and according to the testimony is an expandable project. The regasified LNG from this facility can provide a new supply source for customers of SDG&E, and to the customers of SoCalGas through the use of the SDG&E system and the Rainbow Corridor as backbone transmission facilities. If a significant amount of this gas is delivered through Otay Mesa, this new supply will diversify the existing gas supply sources and may result in increased supply reliability over time. In addition, this new supply of gas will help moderate gas prices in the southern California market by competing with other gas suppliers.

In order to encourage Sempra LNG and Coral to deliver their gas from the ECA facility into southern California, the proposal for integrated rates for the transmission systems of both SDG&E and SoCalGas must be considered. The

existing gas transmission operations of SDG&E and SoCalGas are already operationally integrated to a large degree. The single integrated rate makes sense when one considers that SDG&E historically received gas from the SoCalGas receipt points, and none of the gas to serve SoCalGas customers has come from a SDG&E receipt point. With the introduction of regasified LNG flowing through Otay Mesa, the method in which SDG&E and SoCalGas can obtain gas will fundamentally change. The customers on both systems will have access to receipt points on both systems, regardless of the supply source, at a single integrated rate. The function of the SDG&E transmission system and the Rainbow Corridor will change from a local transmission function to backbone transmission lines transporting regasified LNG from Otay Mesa into SoCalGas' service territory. When these factors are considered, the cross-subsidy arguments are less compelling. Instead of shifting costs to SoCalGas customers for the benefit of Sempra LNG and SDG&E customers, a new supply source will be created for all customers in southern California. This new supply source can mitigate the price of gas entering into the southern California market. When the rate increase to SoCalGas customers is balanced against the benefits of gas flowing through Otay Mesa, we are persuaded that these benefits outweigh the concerns over cross subsidies and the rate impact on SoCalGas customers. In addition, the Energy Action Plan of this Commission and the California Energy Commission encourages the promotion of infrastructure enhancements such as diversifying supply sources to include LNG.

We also note that a single integrated rate on the two transmission systems is beneficial in that it prevents a shift in additional costs to SoCalGas customers. If the system integration proposal is not adopted, separate transmission rates would apply to customers of SDG&E and SoCalGas. If SDG&E customers

choose to take gas from Otay Mesa, instead of through the SoCalGas receipt points, SoCalGas will lose gas throughput and SDG&E's wholesale gas transmission revenues. As a result, the costs associated with these lost volumes and transmission revenues will be shifted to the remaining customers of SoCalGas when costs are reallocated, and the rates of the remaining customers will increase.

3. LNG Gas Volume Considerations

The amount of gas that flows through Otay Mesa is pertinent to the issue of whether SoCalGas customers will benefit as a result of the increase in their transmission rates. The proponents of system integration contend the introduction of regasified LNG through Otay Mesa will result in gas supply reliability, and help moderate gas prices through gas-on-gas competition. The opponents of system integration contend it is uncertain whether any regasified LNG will flow to SoCalGas customers.

The parties opposed to the system integration proposal contend that a large amount of the regasified LNG has already been committed, and any remaining gas can flow to east-of-California customers or be consumed in Mexico. In addition, the gas can be delivered to the SoCalGas gas system at Blythe/Ehrenberg without the need to integrate the two transmission rates. The amount of gas that will flow through Otay Mesa will also depend on the resolution of the gas quality and firm access rights issues, as well as contractual obligations. They assert that if large volumes of gas do not flow through Otay Mesa, SoCalGas customers will receive no benefits from the system integration proposal and end up with higher transmission rates.

It is premature at this point to assess how much gas will actually flow through the Otay Mesa receipt point. Before deciding what they will do with

their uncommitted regasified LNG from the ECA facility, Sempra LNG and Coral are waiting for the Commission to decide the system integration proposal, gas quality, and firm access rights. As the Commission decides each of these issues, Sempra LNG and Coral will be in a better position to decide where they want to deliver the gas to.[16] Sempra LNG and Coral will also need to gauge the interests of customers in southern California who are willing to enter into contracts for delivery of this gas, and to commit the resources for any needed infrastructure investments. All of these factors will influence how much gas will flow through Otay Mesa, and how much of that gas will flow to customers of SoCalGas. If the regulatory and business climate is favorable, Sempra LNG and Coral express a willingness to send regasified LNG through Otay Mesa. Once this occurs, we will be able to access the impact of these gas flows on SDG&E and SoCalGas customers.

Based on SDG&E's average daily throughput and gas supply commitments, both Coral and Sempra LNG anticipate that initial sales in SDG&E's service territory will be 200 MMcfd or less. If the need of the SDG&E customers is 140 MMcfd, which is the existing minimum demand on SDG&E's system, 60 MMcfd would flow into the SoCalGas system. Sempra LNG and Coral have also explored the possibility of expanding the ECA terminal capacity, which could result in additional gas supplies flowing through the Otay Mesa receipt point into the SoCalGas system.

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[16] Hearings on the gas quality issues were held in R.04-01-025, and briefs have been filed. The firm access rights issues will be addressed in 2006.

Of the 1 Bcfd of production at the ECA facility, Coral has committed 300 MMcfd of firm capacity on Bajanorte and North Baja to the interconnection with El Paso. Coral is waiting to decide where it will send its remaining 200 MMcfd of gas. Coral has also requested SDG&E and SoCalGas to do engineering studies for an interconnect capacity at Otay Mesa of 800 MMcfd, with a firm takeaway capacity of up to 600 MMcfd. Coral and Sempra LNG also participated in the open season to upgrade the TGN pipeline in Baja California to connect to Otay Mesa, and have requested that the pipeline be built out to 800 MMcfd.[17]

Although the amount of gas that will flow through Otay Mesa is uncertain at this point in time, we should not reject the system integration proposal solely on that basis. As discussed in the previous section, the potential benefits are several. These benefits include diversity and reliability of supply, and gas-on-gas competition. We should take the necessary action to encourage these suppliers of regasified LNG to ship their gas to the southern California market. By doing so, this will allow time for market forces to develop and shape how the gas from the ECA facility will make its way into California.

If the entry of this gas into the southern California market does not result in the anticipated benefits, we remain open to revisiting whether the single integrated rate for both transmission systems should continue. That is, if significant gas supplies through Otay Mesa do not materialize, and gas-on-gas competition does not occur, the parties may file a petition for modification of this

[17] The improvements on the TGN pipeline are expected to range in cost from $200 to $300 million.

decision requesting that the Commission examine whether continuation of a single integrated rate is still appropriate in light of market conditions. At this point in time, it is appropriate to provide shippers of regasified LNG from Baja California with the opportunity to send this gas into the southern California market.

4. Gas Price Considerations

Some of the parties opposed to the system integration proposal contend that the rate increase to SoCalGas customers will not be offset by the price reduction in the cost of regasified LNG from Baja California. The parties who support the adoption of the proposal contend that the benefits outweigh the increase in the transmission rate.

Several witnesses testified that an increase in the gas supply to the southern California market will be beneficial. The increase in supply from another source will result in a more diverse supply and increase supply reliability over time. This increase in supply is likely to have a dampening effect on gas prices, which will result in a benefit to customers who purchase gas in that market. Some of the parties expect that the introduction of a new gas supply into the southern California market may reduce gas costs by 12 cents per thousand cubic feet (Mcf) for one Bcfd of added gas supplies, and 15 cents per Mcf for two Bcfd or more of added gas supplies.

Although these benefits will not materialize until the regasified LNG begins to flow into southern California, it is our belief that the introduction of regasified LNG from Baja California into the southern California market will benefit the customers of both SDG&E and SoCalGas. We should do our part to encourage the entry of additional gas supplies into the southern California market. This is consistent with the goal of the Energy Action Plan, as discussed

earlier, and with our prior actions in D.04-09-022. In D.04-09-022, we recognized that a diverse portfolio approach for interstate pipeline capacity across different supply basins, including potential sources of LNG, maximizes the opportunities for enhanced supply reliability and gas price stability. We also designated Otay Mesa as a joint receipt point for both the SoCalGas and SDG&E gas systems to provide potential LNG suppliers with access to the southern California market. (See D.04-09-022, pp. 19, 42, 63, 82, 87.)

By adopting the system integration proposal, customers of both SDG&E and SoCalGas will have access to another source of supply, and to diverse supply sources at a single transmission rate. This additional supply should help moderate gas prices as a result of competition. These likely benefits outweigh the rate increase to SoCalGas customers.

5. Infrastructure Investment Considerations

The parties who favor the system integration proposal contend its adoption will encourage the suppliers of LNG from Baja California to make the infrastructure investments needed to transport their gas into SoCalGas' service territory in order to maximize the sale of their gas. As discussed earlier, small volumes of regasified LNG through Otay Mesa are likely to be consumed by SDG&E customers. In order to deliver regasified LNG to customers in SoCalGas' service territory through Otay Mesa, infrastructure improvements will be needed. The cost of the infrastructure improvements will vary depending on the volume of gas that is transported, and whether displacement or incremental capacity is being added.

Some of the parties contend that the regasified LNG from Baja California can be delivered into the southern California market through SoCalGas' interconnection with El Paso, or by paying pancaked rates for gas that flows

through Otay Mesa. They also assert that it is cheaper to expand the SoCalGas capacity at the interconnection with El Paso instead of making infrastructure investments downstream of the Otay Mesa receipt point.

These arguments overlook how SDG&E and SoCalGas historically obtained their gas, and the direct route that this gas could take from Otay Mesa through the Rainbow Corridor into SoCalGas' service territory. The availability of regasified LNG through Otay Mesa will change how SDG&E customers receive their gas and will impact SoCalGas customers as well. Instead of having to procure gas through a receipt point on the SoCalGas system, SDG&E customers will be able to obtain gas directly at the Otay Mesa receipt point. Depending on the volume of gas flowing through Otay Mesa, SoCalGas customers can access this gas supply directly through the SDG&E system and the Rainbow Corridor. This route offers a more direct path than having to transport the regasified LNG in a circuitous manner through the Bajanorte, North Baja, El Paso, and SoCalGas pipelines.

Not having to pay pancaked rates for transportation over this direct route will encourage this source of supply to flow into the southern California market, and for infrastructure investments to be made upstream and downstream of Otay Mesa.[18] The suppliers of regasified LNG from Baja California will then have to decide whether it is cost effective to make the infrastructure investments needed to directly route this gas from Otay Mesa into the service territories of SDG&E and SoCalGas, as well as the infrastructure improvements needed in

[18] This direct route and a single integrated rate are consistent with our pronouncement in D.04-09-022 at page 68 that "any solution to transmission access problems will be based on efficiency and fairness to both affected ratepayers and suppliers."

Baja California to move the gas to Otay Mesa. We should allow the suppliers to make those investment decisions by minimizing the market barriers to allowing regasified LNG to flow through Otay Mesa.

TURN has proposed that the Commission make the approval of the system integration proposal contingent on a commitment by the utilities to refrain from proposing or supporting rolled-in rate treatment of the costs related to the potential capacity expansion of the Otay Mesa receipt point. We do not adopt that condition. Instead, we continue to adhere to the policy that we adopted in D.04-09-022 that LNG suppliers pay the infrastructure costs associated with their projects, and that a request for rolled-in, or any alternative ratemaking treatment, be allowed by filing an application and addressed on a case-by-case basis.

The issue of what scheduling rights one should receive in exchange for making infrastructure investments is addressed in the Joint Recommendation. The Joint Recommendation provides that the party who expands capacity on an incremental basis should have a priority in scheduling. Such a recommendation makes sense from the point of view that one who makes the investment should receive something in return. However, the Joint Recommendation was not brought to the parties' attention until the opening briefs were filed. No one had the opportunity during the evidentiary hearings to inquire about the Joint Recommendation or its relationship to the firm access rights phase. As discussed in the Joint Recommendation section, we decline to adopt the recommendations in the Joint Recommendation.

6. Pancaked Rate Considerations

Parties who oppose the system integration proposal contend that if shippers of regasified LNG from Baja California want to transport gas through Otay Mesa into SoCalGas' service territory, that customers should pay the

SDG&E and SoCalGas transmission rates. In the alternative, they contend that this gas can be delivered into the SoCalGas system at the interconnection with El Paso. The parties who support the system integration proposal contend that pancaked rates result in transmission rates based on whether the gas is received at a SoCalGas or an SDG&E receipt point without regard to the distance involved or the fact that the two systems are already operationally integrated.

The flow of regasified LNG into the SDG&E transmission system will change the way in which SDG&E obtains gas for its customers. Instead of obtaining gas from a receipt point on the SoCalGas system, SDG&E will be able to access the regasified LNG at Otay Mesa. This change raises the question as to whether customers on the SoCalGas system should have to pay pancaked rates in order to access this gas supply through Otay Mesa, or whether a single integrated rate should apply to all customers on the SDG&E and SoCalGas systems.

As discussed in the earlier sections, the introduction of regasified LNG from Baja California is likely to confer benefits on the customers of both SDG&E and SoCalGas. Although there is a cost shift to SoCalGas customers under the system integration proposal, we believe that the benefits from this additional gas supply source outweigh this cost shift.

The retention of two transmission rates will discourage the development of the additional source of supply from Baja California. If SoCalGas customers have to pay two rates to access the gas supply from Otay Mesa, these customers are unlikely to procure gas from this supply source.

If pancaked rates apply to access gas from Otay Mesa, such a situation will increase the likelihood that the regasified LNG will be delivered to El Paso over the Bajanorte and North Baja pipelines and sold to east-of-California customers.

That is because the marketers of this gas, under a pancaked rate scenario, are less likely to make the investments needed to flow this gas through Otay Mesa and into SoCalGas' service territory. In addition, having to pay pancaked rates will discourage customers in SoCalGas' service territory from obtaining their gas through the Otay Mesa receipt point. As noted in the earlier section on the subsidy and rate impact considerations, as more of the regasified LNG is purchased to meet the needs of SDG&E customers, SoCalGas will suffer a loss in SDG&E's wholesale transmission revenues, which will shift additional transmission costs onto the rest of the SoCalGas customers.

Eliminating the pancaked rate structure will help to minimize the delivery cost of regasified LNG from Baja California. In return, customers in the southern California market will receive the benefits that we described earlier, such as diversity and reliability of supply, and gas-on-gas competition.

IP/Watson/CMTA propose that instead of a pancaked rate structure, the interim rates approved in D.04-09-022 should remain as the permanent transmission rates for the delivery of gas into the SDG&E and SoCalGas systems. The interim rate consists of the transportation rate on the local utility, i.e., either the applicable SDG&E or the SoCalGas tariff rate. (See D.04-09-022, p. 63.)

Shortly after the opening briefs were submitted in this proceeding, we modified D.04-09-022 by eliminating the interim rate for gas flowing through the Otay Mesa receipt point in D.05-10-045. We also stated that should gas move through Otay Mesa, that SDG&E and SoCalGas could file an application to set interim rates pending the issuance of this decision. (D.05-10-045, p. 5.) Since today's decision approves the adoption of the system integration proposal and the integrated transmission rates, there is no further need to address the applicability of the interim rate to this proceeding.

7. Peaking Rate Considerations

SDG&E and SoCalGas contend that if the system integration proposal is adopted, the SoCalGas peaking rate should not apply to SDG&E if it procures gas through the Otay Mesa receipt point, and it should not apply if a noncore customer of SoCalGas obtains gas through Otay Mesa. Some of the parties opposed to the system integration proposal contend that the peaking rate should still apply, or that the peaking rate should be eliminated altogether.

Peaking service is offered by SoCalGas under Schedule GT-PS. The peaking service tariff applies to gas transportation service provided to any noncore customer who bypasses SoCalGas' service, in part or in whole. Bypass takes place where a customer of SoCalGas becomes connected to, and receives gas from an alternate supply source or an alternate gas transportation service provider.

SDG&E and SoCalGas contend that the peaking rate should not apply to SDG&E and to noncore customers of SoCalGas because D.04-09-022 designated Otay Mesa as a joint receipt point. They contend that the peaking rate should not apply because it was not intended to apply to the situation where a noncore customer of SoCalGas, such as SDG&E, becomes a major supplier of gas to SoCalGas. In addition, they contend that the peaking rate should not apply because the Commission expressed support for accessing new gas supplies in D.04-09-022.

In the August 5, 2005 ruling, the assigned ALJ allowed certain testimony to remain in this proceeding concerning the peaking rate and its effect on the system integration proposal. Today's decision only addresses the applicability of the SoCalGas peaking rate to the system integration proposal. Whether or not

the peaking rate should be eliminated in its entirety is an issue that will be addressed in the firm access rights phase of this proceeding.[19]

When the SoCalGas peaking rate was first developed, it was not contemplated that LNG would be a new supply source for SDG&E and SoCalGas, or that Otay Mesa would become a joint receipt point. These changes should be considered in deciding whether SoCalGas' peaking rate should apply to its noncore customers who procure gas through the Otay Mesa receipt point. With the creation of Otay Mesa as a joint receipt point in D.04-09-022, the gas that flows through Otay Mesa should be treated the same as gas that flows through the receipt points on the SoCalGas system. Since the peaking rate tariff does not apply when a noncore customer receives gas through a SoCalGas receipt point, the peaking rate tariff should not apply when a noncore customer of SoCalGas, including SDG&E, procures gas through the joint receipt point of Otay Mesa.

The peaking rate issue can also be viewed in the context of how the single integrated transmission rate will operate. Under system integration, the transmission costs of both SDG&E and SoCalGas are combined and a single integrated rate applies. The customers of both SDG&E and SoCalGas continue to pay a share of the SoCalGas transmission costs. As a result, there is no bypass of the SoCalGas transmission costs.

Accordingly, we conclude that SoCalGas' peaking rate tariff should not apply if a noncore customer of SoCalGas, including SDG&E, obtains gas through the Otay Mesa receipt point and system integration is approved.

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[19] This same issue is likely to arise with respect to the other California-based LNG project proposals, and should be addressed in the firm access rights phase of this proceeding.

8. Allocation Methodology Considerations

SDG&E and SoCalGas propose that the system integrated rates that appear in Attachment 1 of Exhibit 9 be adopted.[20] These rates were developed based on the LRMC allocation methodology adopted in the most recent BCAP decision (D.00-04-060) of SDG&E and SoCalGas, and the use of a cold-year throughput allocator for the transmission costs of SDG&E and SoCalGas. Cold-year throughput is the Commission-adopted allocator for backbone transmission costs. Although the cost allocation methodology may change in the next BCAP, SDG&E and SoCalGas contend that the Commission should continue to use the adopted methodology until such a change is adopted.[21]

IP/Watson/CMTA recommend that if the system integration proposal is adopted, instead of using cold-year throughput to allocate the transmission costs of SDG&E and SoCalGas, the Commission should allocate 47% of these costs on the basis of cold-year peak month throughput and 53% of these costs on the basis of cold-year throughput. This allocation is based on the allocation of local transmission costs on a cold-year peak month throughput, and backbone transmission costs on the basis of cold-year throughput. This allocation was used in the Comprehensive Settlement Agreement (CSA) to determine that SoCalGas' transmission system was 50% backbone and 47% local. The CSA was adopted in D.01-12-018, but has not yet been implemented.[22] IP/Watson/CMTA

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[20] The rates shown in Attachment 1 of Exhibit 9 are based on the scaled transmission costs that appear in Table 1 at page 6 of Exhibit 9.

[21] See footnote 11.

[22] To trace the status of the CSA, see Ordering Paragraph 4 of D.04-04-015, and D.04-09-022 at page 73.

assert that the proposal of SDG&E and SoCalGas to allocate all of the transmission costs on a cold-year throughput basis fails to recognize that a significant portion of the utilities' transmission system functions as local transmission.

TURN proposes that if the system integration proposal is adopted, the Commission allocate costs using an embedded cost methodology, instead of LRMC. TURN recommends the embedded cost methodology be used because it is consistent with how transmission service on the PG&E system is priced, and to ensure that changes in distribution and customer-related marginal costs on both systems do not impact the level of the integrated transmission rate.

Other parties recommend that the system integration proposal be adopted as policy in this proceeding, but the actual implementation of the system integrated rates be delayed until the next BCAP or until regasified LNG begins to flow through Otay Mesa. If the rates are not deferred until the BCAP, ORA recommends a three-year phase-in of the system integrated rates in order to mitigate the rate impacts on various customer classes.

For several reasons, we agree that the methodology that SDG&E and SoCalGas used to develop the system integrated rates should be adopted. First, their methodology is based on the LRMC methodology in the most recently adopted BCAP in D.00-04-060. Second, the use of the cold-year allocator for the transmission costs of both utilities is appropriate because the SDG&E system and the Rainbow Corridor are likely to serve a backbone function once sufficient volumes of gas flow through Otay Mesa. Third, the CSA has not been implemented, and under the CSA the Rainbow Corridor is considered local transmission. And fourth, it is not feasible to wait until the next BCAP to develop system integrated rates because of the time it will take to resolve the

BCAP, and because the ECA facility is scheduled to come on line in the early part of 2008.

All of the parties will have an opportunity in the next BCAP to advocate whether an embedded cost methodology should be used, whether different allocations should be used for the transmission costs, and to update costs. Once those kinds of changes are adopted in the next BCAP, that would be an appropriate time to revise the system integrated rates to reflect the changes adopted in that BCAP. Until such time, the system integrated rates that appear in Attachment 1 of Exhibit 9 and which are attached to this decision as Appendix A, shall be used as the system integrated rates for SDG&E and SoCalGas, subject to possible revisions due to regulatory updates with the Commission that occurred after the development of the rates shown in Appendix A.

Once the allocation methodology is adopted, the next consideration is when the system integrated rates should go into effect. ORA and some of the other parties recommend a phase-in of the rates, while others recommend the rates go into effect when regasified LNG begins to flow at Otay Mesa.

A phase-in of the system integrated rates would help mitigate the rate impact on customers. However, customers will not experience any of the benefits associated with having regasified LNG flow through Otay Mesa until that gas supply begins to flow. Instead of implementing the system integrated rates on a phase-in basis, we believe that the rates should be implemented when the regasified LNG from Baja California begins to flow through Otay Mesa. This will better match the implementation of the rate changes to the event that will result in the flow of gas through Otay Mesa which will benefit the gas customers of SoCalGas and SDG&E. SDG&E and SoCalGas should be directed to

implement the updated system integrated rates to its customers when regasified LNG from Baja California begins to flow through the Otay Mesa receipt point. Based on the testimony in this proceeding, we expect the flow of gas to begin around the first quarter of 2008.

9. ITBA Considerations

As part of the system integration proposal, SDG&E and SoCalGas propose that the ITBA be created. The purpose of the ITBA is to record the difference between the actual transmission revenues and the adopted transmission revenues for the two utilities on a combined basis. They propose that the difference in the ITBA be allocated to all customer classes for the two utilities based on cold-year throughput in the following year's transportation rates.

SCGC opposes the proposal to create the ITBA because it provides SDG&E and SoCalGas with 100% balancing account protection against throughput risk for recovery of their integrated revenue requirement on an indefinite basis. SCGC points out that D.02-12-017 authorized 100% balancing account protection for the costs recorded in the NFCA on an interim basis until the next BCAP rates go into effect.

SCGC also opposes the ITBA because it shifts revenues between the two utilities and among customer classes through the balancing of the Sempra-wide transmission revenue requirement against the Sempra-wide transmission revenues and allocating the over-collection or under-collection to all customer classes for the two utilities. SCGC contends that the ITBA is unnecessary because SDG&E and SoCalGas already have the CFCA and an NFCA, which do not result in a shift of revenues between the utilities and among customer classes.

We believe that SDG&E and SoCalGas should be allowed to create the ITBA. The ITBA uses the same methodology, i.e., cold-year throughput, to

develop the integrated non-fuel transmission costs of both utilities, for use in any under- or over-collection of the integrated transmission costs. As for the concern that the ITBA prejudges the issue of the 100% balancing account protection for the throughput for the transmission revenue requirement, SoCalGas acknowledges that the ITBA should not prejudge any outcome regarding throughput risk and is willing to reflect whatever throughput risk that may be adopted in a future proceeding such as the next BCAP. We make clear in today's decision that this balancing account protection issue is to be revisited in the next BCAP or other appropriate proceeding, and that this portion of the ITBA may change to reflect how that issue is resolved in the future. SDG&E and SoCalGas should be permitted to establish the ITBA.

10. Rainbow Corridor Considerations

The Rainbow Corridor pipelines have a theoretical capacity of 1 Bcfd, but because of operating pressures, the effective capacity between Moreno Station and Rainbow Station is 750 MMcfd. At the present time, about 700 MMcfd of this capacity serves SDG&E's load,[23] and 50 MMcfd serves SoCalGas' load along the Rainbow Corridor. The direction of the gas flow on the Rainbow Corridor is north to south.

In the scoping memo and in Resolution G-3377, we expressed concern about potential capacity constraints along the Rainbow Corridor, whether these pipelines should be treated as backbone, local transmission or as a receipt point, and the impact of these concerns on the system integration proposal.

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[23] 45 MMcfd of the 700 MMcfd is reserved as an operating margin.

When SDG&E and SoCalGas submitted their testimony in this proceeding, they stated that "there is no capacity constraint in SoCalGas' Rainbow Corridor," and that "SoCalGas is able to meet all existing customer requirements from these pipelines." (Ex. 4, p. 6.) The testimony also stated that conclusions about new customer demand in the Rainbow Corridor were still speculative. If new load materializes on the Rainbow Corridor which degrades SDG&E's system capacity, SDG&E and SoCalGas would identify the most economic means to improve the capacity of the SDG&E system. Their testimony also included various examples of possible capacity expansions and the estimated costs.

Their testimony also states that the classification of the Rainbow Corridor facilities as backbone or local transmission should follow the operational functions. Once customers have access to gas supplies at Otay Mesa, SDG&E and SoCalGas contend that these lines will function as backbone transmission lines. SDG&E and SoCalGas assert, however, that the classification of the Rainbow Corridor as local or backbone transmission lines does not change or affect the system integration proposal.

In a December 6, 2005 news article in The Press-Enterprise, it was reported that construction work for the Inland Empire Energy Center in Romoland, south of Moreno Valley, had begun. According to the article, General Electric Company (GE) started construction of a 775 megawatt power plant at this location, which is expected to come on line in 2008.[24] The article also stated that a subsidiary of Edison International was seeking approval to build a 500 megawatt power plant nearby.

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[24] The information about the GE plant was disclosed in a February 13, 2006 letter from SDG&E and SoCalGas to ALJ Weissman, and served on the service list in R.04-01-025.

The construction of the GE plant is likely to impact the available capacity along the Rainbow Corridor. This is one of the issues that we identified in the scoping memo and Resolution G-3377. If the gas to feed this plant comes from SoCalGas' existing receipt points, the capacity to SDG&E's service territory along the Rainbow Corridor will probably be affected to some degree. The construction of the GE facility makes it all that more important to look to, and facilitate the delivery of natural gas from alternate gas supplies, such as regasified LNG flowing through Otay Mesa. However, this is not the appropriate proceeding in which to study and decide what capacity expansions may be needed along the Rainbow Corridor to accommodate the increase in gas demand.[25]

The second Rainbow Corridor issue is whether the corridor should be treated as a local transmission, backbone transmission, or as a receipt point, and the impact this could have on the system integration proposal and the ability to move regasified LNG from Otay Mesa. Currently the Rainbow Corridor is classified as local transmission on the SoCalGas system. Under the system integration proposal, the Rainbow Corridor and SDG&E's transmission pipelines are expected to provide a backbone transmission function to SoCalGas, and the transmission costs of the Rainbow Corridor are allocated on that basis. Accordingly, no changes to the system integration proposal are needed due to how the Rainbow Corridor is treated in the proposal.

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[25] As noted in the February 13, 2006 letter to ALJ Weissman, SDG&E and SoCalGas plan to conduct an open season after a decision is adopted on the Phase II infrastructure issues in R.04-01-025. The open season will assess customer demand on the Rainbow Corridor and on the SDG&E system for the time period beginning May 2007.

11. Merger and Reorganization Decisions

In the merger decision, D.98-03-073, we allowed the merger of the parent companies of SoCalGas and SDG&E, and adopted certain mitigation measures in Attachment B of the merger decision. SoCalGas and SDG&E retained their existing legal and regulatory status, and were allowed to functionally integrate their operations.[26] (D.98-03-073 [79 CPUC2d at pp. 354-355].) In the reorganization decision, D.01-09-056, we granted the request of the two utilities to further integrate the management of certain utility operations and to return certain transactional support services to the utilities.

The system integration proposal would combine the transmission costs of the two transmission systems in order to allow the customers of both utilities to have access to natural gas at all existing and new receipt points on both systems at a single, integrated transmission rate.

Such a proposal is not contrary to the merger decision or to the reorganization decision in D.01-09-056. In D.98-03-073, we adopted mitigation measures which permit SDG&E and SoCalGas to be "organized in a manner that allows them to provide the highest quality utility service that focuses on safety and reliability, and is responsive to customers' needs," and "to the extent that it makes business sense, share resources with the other utility Affiliate." (D.98-03-073, Att. B [79 CPUC2d at p. 453].) The system integration proposal would essentially share the existing and new receipt points on the two transmission systems at a single integrated rate. The proposal is in response to

[26] In the merger application, the utilities specifically requested that the combined company's gas operations be operated independently of, and physically separated from, its gas acquisition. (See D.01-09-056, p. 6.)

the new source of gas supply that will be imported into Baja California, some of which will flow through Otay Mesa. In D.04-09-022, we designated Otay Mesa as a joint receipt point for SDG&E and SoCalGas. The proposal responds to the needs of the customers of SDG&E and SoCalGas by providing access to new and existing receipt points on both systems at a single integrated rate. We conclude that the system integration proposal is within the merger decision's grant of authority as well as the reorganization authorized in D.01-09-056.

As for the argument that the system integration proposal results in a subsidy to an affiliate, the mitigation measures adopted in D.98-03-073 provide in part that when assets, goods and services are transferred or provided between the utility affiliates and the non-utility affiliates, that there must be prompt and fair compensation or reimbursement. In addition, there is to be no preferential treatment by a utility affiliate in favor of a non-utility affiliate. (See 79 CPUC2d at pp. 450-451, 453-455.)

Although Otay Mesa will act as an entry point for regasified LNG owned by Sempra LNG, an affiliate of SDG&E and SoCalGas, Otay Mesa will also be an entry point for Coral's regasified LNG. Today's decision does not prevent other LNG project developers in Baja California from transporting their gas through Otay Mesa in the future. In addition, gas suppliers who use receipt points in SoCalGas' service territory will be able to move their gas to SDG&E's service territory using the same integrated transmission rate that Sempra LNG is subject to. Furthermore, the cost of improving the system infrastructure costs is to be borne by the LNG suppliers, with the opportunity to request rolled-in ratemaking treatment. In light of these factors, we do not agree with the argument that the adoption of the system integration proposal will result in the preferred treatment of Sempra LNG.

12. Joint Recommendation

The Joint Recommendation was first brought to our attention in the opening briefs of the four parties who request that it be adopted. The only opportunity for parties to respond to the Joint Recommendation was in the reply briefs.

Several of the parties expressed their opposition in their reply briefs to the adoption of the Joint Recommendation. They contend the Joint Recommendation should not be adopted for the following reasons: (1) the Joint Recommendation was not raised during the evidentiary hearing and parties did not have an opportunity to rebut the recommendations or to subject the recommendations to cross examination; (2) portions of the Joint Recommendation are vague and ambiguous and parties have not had an opportunity to clarify these issues; (3) portions of the Joint Recommendation address firm access rights which are to be litigated in Phase 2 of this proceeding; (4) the Joint Recommendation undermines gas-on-gas competition because it could concentrate the amount of available capacity to one or two suppliers, or preclude new suppliers from entering the market; (5) the Joint Recommendation adopts incremental cost allocation for expanding capacity at Otay Mesa, while D.04-09-022 provides an opportunity for rolled-in ratemaking treatment; and (6) the record regarding the system integration proposal is complete and should be evaluated without reference to the Joint Recommendation.

We decline to adopt the Joint Recommendation as part of the system integration framework that we adopt today. Although the recommendations may have merit, the parties to this proceeding were not informed of the Joint Recommendation until the opening briefs were filed after the close of hearings in the system integration phase. The parties were not provided with notice or an

opportunity to be heard regarding the Joint Recommendation. In addition, several of the recommendations resolve firm access rights issues, which are supposed to be resolved in the firm access rights phase of this proceeding. Due to these procedural problems, we decline to adopt the Joint Recommendation.

13. Conclusion

Based on all of the above considerations, the system integration proposal of SDG&E and SoCalGas should be adopted. Although the integration of the transmission costs of the two utilities will result in higher transmission rates to the customers of SoCalGas, we believe that the flow of regasified LNG from Baja California through Otay Mesa will benefit the customers of SDG&E and SoCalGas. The rate impact on the customers of SoCalGas is outweighed by the benefits of having access to an alternate supply source of natural gas, and the price pressure that should result from this new source.

The adoption of the system integration proposal will eliminate the need for pancaked rates, which should encourage investment in the infrastructure of SDG&E and SoCalGas, and to upstream pipelines located in Baja California. Today's decision also promotes the goal in the Energy Action Plan of diversifying supply sources to include LNG, and to ensure "that adequate, reliable, and reasonably-priced … natural gas supplies, including prudent reserves, are achieved and provided through policies, strategies, and actions that are cost-effective and environmentally sound for California's consumers and taxpayers." (Energy Action Plan II, p. 10.)

With the construction of the ECA facility well underway in Baja California, we should not ignore the potential benefits that this facility can bring to the natural gas market in southern California. We should do all that we can to facilitate the entry of regasified LNG to serve California's natural gas needs. This

is especially important at a time when natural gas prices have risen to new levels, the outlook for domestic supplies remains cautionary, and there is increasing demand for natural gas to fuel electric generation.

Adopting the system integration proposal will provide assurances to the project sponsors of the LNG projects in Baja California, and to the marketers of that gas, that they will be able to deliver their gas supply to customers in southern California. Since these project sponsors and marketers plan to make significant investments, they need to know if there is going to be a market that they can supply their gas to, and what the framework will be for delivering that gas.

Therefore, the system integration proposal of SDG&E and SoCalGas shall be adopted. SDG&E and SoCalGas shall be allowed to integrate the transmission costs of both utilities, and to allocate those costs to the customers of both utilities using the allocation methodology described in this decision. The rates set forth in Appendix A of this decision shall be updated in an advice letter to reflect all rate updates that were presented to the Commission after the rates in Appendix A were developed. The advice letter shall be filed with the Energy Division 120 days before the flow of regasified LNG through Otay Mesa is expected. Those updated transmission rates shall apply to the customers of SDG&E and SoCalGas, and shall go into effect on the first day of the month in which regasified LNG is expected to flow through Otay Mesa.

In the event the regasified LNG from Baja California does not develop and flow through Otay Mesa in sufficient quantities to justify the system integrated transmission rates, we remain open to reviewing whether the integrated rates should continue. Some experience with the flows through Otay Mesa should

occur before a party decides whether a petition to modify this decision is warranted.

IV. Categorization and Need for Hearings

The May 24, 2005 scoping memo confirmed that the category for this proceeding is ratesetting, and that hearings would be held.

V. Comments on Proposed Decision

The proposed decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code §311(d) and Rule 77.1 of the Rules of Practice and Procedure. The comments and reply comments to this proposed decision have been considered and appropriate changes have been made to this decision.

VI. Assignment of Proceedings

Geoffrey F. Brown is the Assigned Commissioner, and John S. Wong is the assigned ALJ in this proceeding.

Findings of Fact

1. The system integration proposal was included in this application in response to D.04-09-022.

2. SDG&E is currently a wholesale customer of SoCalGas, and receives all of its natural gas from SoCalGas at the Rainbow and San Onofre meter stations.

3. If regasified LNG is delivered through Otay Mesa, natural gas could flow from SDG&E to SoCalGas.

4. Currently, none of the gas delivered to an end-use customer in SoCalGas' territory comes from a receipt point on SDG&E's system.

5. The system integration proposal provides the framework for allowing customers of both SoCalGas and SDG&E to access gas supplies at existing or new receipt points on both systems at a single integrated transmission rate.

6. The gas transmission systems of SoCalGas and SDG&E are currently integrated on an operational basis, but the transmission and distribution costs of the two utilities remain separate.

7. Under the proposal, the customers of SoCalGas and SDG&E would continue to pay their respective distribution rates.

8. Under the proposal, the pancaking of transmission rates would be eliminated so that a customer located on the SoCalGas system would not have to pay a wheeling charge to SDG&E to move gas north from Otay Mesa into SoCalGas' territory.

9. Under the proposal, SoCalGas' peaking rate would not apply if SDG&E or a customer in SoCalGas' service territory takes gas from Otay Mesa.

10. Under the proposal, the gas transmission rates for all SoCalGas customers would go up, except for EG customers, and the gas transmission rates for SDG&E customers would decrease.

11. The rate impact of the cost shift to SoCalGas customers amounts to approximately $14.4 million.

12. The Rainbow Corridor pipelines currently function as local transmission because SoCalGas does not receive any gas from SDG&E.

13. The Joint Recommendation was attached to the opening briefs of four of the parties.

14. The potential change in the direction of the flow of gas is the impetus for the system integration proposal, and represents a fundamental change in how SDG&E and SoCalGas can obtain gas.

15. The ECA facility is currently being built in Baja California, and is likely to be the first LNG project on the west coast.

16. The Commission has a window of opportunity to decide whether to encourage the entry of LNG from Baja California into California, or to wait and see whether the California-based LNG projects will be approved or not.

17. The regasified LNG from the ECA facility can provide a new supply source for customers of SDG&E, and to customers of SoCalGas through the use of the SDG&E system and the Rainbow Corridor as backbone transmission facilities.

18. If a significant amount of gas is delivered through Otay Mesa, this new supply will diversify the existing gas supply sources and may result in increased supply reliability over time, and help moderate gas prices in the southern California market.

19. The single integrated rate makes sense when one considers that SDG&E historically received gas from the SoCalGas receipt points, and none of the gas to serve SoCalGas customers has come from a SDG&E receipt point.

20. The Energy Action Plan encourages the promotion of infrastructure enhancements such as diversifying supply sources to include LNG.

21. If the system integration proposal is not adopted, and SDG&E customers choose to take gas from Otay Mesa instead of from receipt points on the SoCalGas system, SoCalGas will lose gas throughput and SDG&E's wholesale gas transmission revenues, which will shift more costs to the remaining customers of SoCalGas.

22. Several factors will influence how much gas will flow through Otay Mesa, and how much of that gas will flow to customers of SoCalGas.

23. Taking steps to encourage suppliers of LNG from Baja California to ship their gas to the southern California market will allow market forces to develop and shape how the gas from the ECA facility will make its way into California.

24. If the anticipated benefits of the system integration proposal do not materialize, we remain open to revisiting whether the single integrated rate for both transmission systems should continue.

25. Encouraging the entry of additional gas supplies into the southern California is consistent with D.04-09-022 in which we recognized the need for a diverse portfolio approach, including potential sources of LNG.

26. Not having to pay pancaked rates for transportation of gas through Otay Mesa will encourage this source of supply to flow into the southern California market, and for infrastructure investments to be made upstream and downstream of Otay Mesa.

27. If SoCalGas customers have to pay two rates to access the gas supply from Otay Mesa, these customers are unlikely to procure gas from this supply source.

28. If pancaked rates apply, this will increase the likelihood that the regasified LNG from Baja California will be sold to east-of-California customers.

29. D.05-10-045 modified D.04-09-022 by eliminating the interim rate for gas flowing through Otay Mesa.

30. The peaking service tariff applies to gas transportation service provided to any noncore customer who bypasses SoCalGas' service, in part or in whole.

31. When the SoCalGas peaking rate was first developed, it was not contemplated that LNG would be a new supply source for SDG&E and SoCalGas, or that Otay Mesa would become a joint receipt point.

32. With the creation of Otay Mesa as a joint receipt point, the gas that flows through Otay Mesa should be treated the same as gas that flows through the receipt points on the SoCalGas system.

33. Having the system integrated rates go into effect when the flow of gas through Otay Mesa begins will better match the implementation of the rate changes to the event that will benefit SDG&E and SoCalGas customers.

34. The issue of balancing account protection for the throughput for the transmission revenue requirement is to be revisited in the next BCAP or other appropriate proceeding.

35. The construction of the GE facility along the Rainbow Corridor makes it all that more important to look to, and facilitate the delivery of natural gas from alternate gas supplies.

36. This is not the appropriate proceeding in which to study and decide what capacity expansions may be needed along the Rainbow Corridor to accommodate the increase in gas demand.

37. The Rainbow Corridor and SDG&E's transmission pipelines are expected to provide a backbone transmission function to SoCalGas, and under the proposal, the transmission costs of those facilities are allocated on that basis.

38. No changes to the system integration proposal are needed due to how the Rainbow Corridor is treated in the proposal.

39. The mitigation measures adopted in D.98-03-073 permit SDG&E and SoCalGas to be organized in a manner that allows them to provide the highest quality utility service that focuses on safety and reliability, is responsive to customers' needs, and to the extent it makes business sense, to share resources.

40. Under the proposal, SDG&E and SoCalGas essentially share the existing and new receipt points on the two systems at a single integrated rate.

41. Today's decision does not prevent other LNG project developers in Baja California from transporting their gas through Otay Mesa in the future.

42. Gas suppliers who use receipt points in SoCalGas' service territory will be able to move their gas to SDG&E's service territory using the same integrated transmission rate that Sempra LNG is subject to.

43. The parties were not provided with notice or an opportunity to be heard regarding the Joint Recommendation.

Conclusions of Law

1. Rejecting or deferring a decision on the system integration proposal will send a negative price signal to Sempra LNG and to Coral, and may result in the loss of Baja California LNG as a supply source.

2. When the rate increase to SoCalGas customers is balanced against the benefits of gas flowing through Otay Mesa, the benefits outweigh the concerns over cross subsidies and the rate impact on SoCalGas customers.

3. The system integration proposal should not be contingent on a commitment by the utilities to refrain from proposing or supporting rolled-in rate treatment of the costs related to the potential capacity expansion of the Otay Mesa receipt point.

4. The system integration proposal should be adopted.

5. Since the peaking rate tariff does not apply when a noncore customer receives gas through a SoCalGas receipt point, the peaking rate tariff should not apply when a noncore customer of SoCalGas, including SDG&E, procures gas through the joint receipt point of Otay Mesa.

6. There is no bypass of the SoCalGas transmission costs under the system integration proposal because the customers of SDG&E and SoCalGas continue to pay a share of the SoCalGas transmission costs.

7. The methodology that SDG&E and SoCalGas used to develop the system integrated rates that are reflected in Appendix A of this decision is adopted.

8. SDG&E and SoCalGas should be allowed to establish the ITBA.

9. The system integration proposal is not contrary to D.98-03-073 or D.01-09-056.

10. The Joint Recommendation is not adopted.

11. The rates set forth in Appendix A shall be updated in an advice letter to reflect all rate updates presented to the Commission after the rates in Appendix A were developed.

12. The updated transmission rates shall apply to the customers of SDG&E and SoCalGas, and shall go into effect on the first day of the month in which regasified LNG is expected to flow through Otay Mesa.

13. If significant gas supplies through Otay Mesa do not materialize, and gas-on-gas competition does not occur, a party may file a petition for modification of this decision requesting that the Commission examine whether continuation of a single integrated rate is still appropriate in light of market conditions.

O R D E R

IT IS ORDERED that:

1. The system integration proposal of San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) is adopted.

   a. SDG&E and SoCalGas shall combine the transmission costs on both systems and develop integrated transmission rates for each customer class of each utility using the allocation methodology discussed in this decision.

   b. SDG&E and SoCalGas shall establish the Integrated Transmission Balancing Account.

   c. The integrated transmission rates shown in Appendix A shall be updated by SDG&E and SoCalGas in an advice letter to reflect all

rate updates that were presented to the Commission after the development of the rates shown in Appendix A.

d. SDG&E and SoCalGas shall file the advice letter with the Energy Division 120 days before the flow of regasified liquefied natural gas (LNG) through Otay Mesa is expected.

e. The updated integrated transmission rates shall go into effect on the first day of the month in which regasified LNG is expected to flow through Otay Mesa.

2. This proceeding remains open to address the remaining issues.

This order is effective today.

Dated _____, at San Francisco, California.