PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

January 27, 2004

Agenda ID #3229
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 03-06-021

This is the draft decision of Administrative Law Judge (ALJ) Wong. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

_/s/ ANGELA K. MINKIN
Angela K. Minkin, Chief
Administrative Law Judge

ANG:jva
Attachment

Decision **DRAFT DECISION OF ALJ WONG (Mailed 1/27/2004)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Gas Company (U 904 G) Regarding Year Nine (2002-2003) of Its Gas Cost Incentive Mechanism.	Application 03-06-021 (Filed June 16, 2003)

OPINION REGARDING YEAR NINE OF THE GAS COST INCENTIVE MECHANISM

I. Summary

Today's decision addresses the Year Nine Gas Cost Incentive Mechanism (GCIM) application filed by Southern California Gas Company (SoCalGas) on June 16, 2003.

The decision finds that SoCalGas reasonably managed its gas acquisitions and operations in Year Nine within the context of the GCIM that existed at the time, and that the calculation and amount of the shareholder award is correct. Pursuant to the GCIM modifications adopted in Decision (D.) 02-06-023, SoCalGas is awarded a shareholder award of $6,318,811 for Year Nine.

Due to the ongoing activities in the Order Instituting Investigation (I.) 02-11-040, the finding of reasonable management shall not prejudge what we may find or conclude in I.02-11-040, and the SoCalGas shareholder award shall be subject to refund or adjustment as may be determined by us in I.02-11-040.

A. Procedural and Factual Background

The GCIM is a Commission-authorized ratemaking mechanism that SoCalGas uses to purchase natural gas on behalf of its core customers. The GCIM replaced the reasonableness reviews of SoCalGas' procurement activities. The GCIM establishes a benchmark against which to measure the price that SoCalGas pays for gas. This provides an incentive for SoCalGas to purchase gas at or below the benchmark. Savings below the tolerance band are shared with ratepayers and SoCalGas' shareholders according to the sharing band adopted in D.02-06-023.

SoCalGas was first authorized to use the GCIM in D.94-03-076 [53 CPUC2d 663]. More recently, in D.02-06-023, the GCIM was modified and SoCalGas was authorized to continue the use of the GCIM on an annual basis until modified or terminated by the Commission.

On June 16, 2003, SoCalGas filed its Year Nine GCIM application. SoCalGas' application describes the results of operations under the GCIM structure for its gas acquisition activities for Year Nine, the period from April 1, 2002 through March 31, 2003.

The Office of Ratepayer Advocates (ORA) filed a response to the application on July 17, 2003. Southern California Edison Company (SCE) filed a protest to SoCalGas' Year Nine GCIM application on July 21, 2003. On July 31, 2003, SoCalGas filed a reply to SCE's protest.

On October 31, 2003, ORA served its Monitoring and Evaluation Report on the Year Nine GCIM.

A prehearing conference (PHC) was held on December 12, 2003 to discuss whether the issues raised by the parties required any evidentiary hearings, and to determine the procedural manner in which to process SoCalGas' application.

On January 15, 2004, the Scoping Memo and Ruling was issued for this proceeding. The Scoping Memo and Ruling determined that no evidentiary hearings were needed because no one contested SoCalGas' calculation of the GCIM award or its operations under the GCIM that existed at the time. The Scoping Memo and Ruling also stated that depending on the outcome in I.02-11-040, a hearing may be needed in this proceeding in the future if the Commission decides in I.02-11-040 that the GCIM should be modified or eliminated on a retroactive basis.

II. Position of the Parties

A. SoCalGas

The Year Nine GCIM application of SoCalGas reports on the results of its gas supply and storage operations for the period April 1, 2002 through March 31, 2003. In accordance with D.02-06-023, SoCalGas requests that the Commission approve a shareholder award of $6,318,811.

SoCalGas' Annual Report for Year Nine, which was attached to SoCalGas' application, notes that "SoCalGas' core customers continued to receive reliable natural gas supplies at below-market cost in Year Nine," and that "ratepayers have realized the benefit of gas purchases below the GCIM benchmark … in eight of the past nine years." (A.03-06-021 Application, Attachment A, p. 1.)

In Year Nine, SoCalGas acquired gas at a total savings of $39,004,326 below the benchmark. Pursuant to the GCIM revisions adopted in D.02-06-023, of this total savings, $32,685,515 is the ratepayers' share, and $6,318,811 is the shareholders' share.

B. SCE

SCE's protest to SoCalGas' application asserts that the GCIM that SoCalGas operates under "creates perverse incentives, harms noncore customers, and has a detrimental impact on the California energy markets." (SCE Protest, p. 2.) SCE also contends that the ongoing Commission investigation (I.02-11-040) into the cause of the natural gas border price spikes from March 2000 through May 2001 may result in the Commission "revisiting the results of Years Seven and Eight and in the modification of the GCIM structure." (SCE PHC Statement, p. 1.) If the GCIM is modified or eliminated, SCE asserts that this will have a direct bearing on whether SoCalGas' award for Year Nine is appropriate.

SCE also stated in its PHC statement:

> "If the Commission goes forward with a decision on the GCIM Year Nine application, the Commission should treat SoCalGas' Year Nine GCIM similarly to Years Seven and Eight, namely, the Commission should make clear that (1) any finding of reasonable management shall not prejudge what the Commission may find or conclude in I.02-11-040, and (2) any award issued for Year Nine shall be made subject to refund or adjustment as may be determined by the Commission based on the investigation." (SCE PHC Statement, p. 1.)

C. ORA

ORA's Monitoring and Evaluation Report for Year Nine was served on October 31, 2003. The report states that ORA conducted a comprehensive audit of the GCIM Year Nine results submitted by SoCalGas in its application. The report also states that ORA verified that the current sharing mechanism resulted in a "total savings of $39.0 million to be split between a ratepayer benefit of $32.7 million and a shareholder reward of $6.3 million." (ORA Monitoring and Evaluation Report, October 31, 2003, p. 1-3.) Based on the results of ORA's

audit, ORA recommends that SoCalGas be authorized to recover a shareholder award of $6,318,811 through SoCalGas' Purchased Gas Account.

III. Discussion

The GCIM is the structure which replaced the Commission's reasonableness reviews of SoCalGas' gas purchases and gas storage activities on behalf of its core sales customers. The GCIM is designed to provide SoCalGas with a financial incentive for making efficient gas purchasing decisions.

SoCalGas' Year Nine application states that it was able to purchase gas at $39,004,326 below the GCIM benchmark. The actual cost of all the purchases subject to the GCIM was $1,467,033,460 and the benchmark cost was $1,506,037,786. Pursuant to the GCIM revisions adopted in D.02-06-023, SoCalGas requests a shareholder award of $6,318,811 for Year Nine.

ORA conducted a review, audit, and evaluation of the Year Nine GCIM results, the results of which are contained in ORA's Monitoring and Evaluation Report for Year Nine. ORA's analysis confirmed the Year Nine GCIM results as follows:

> "(a) the GCIM resulted in total shared savings of $39,004,326, to be shared between ratepayers and SoCalGas shareholders. The shared savings were based on the difference between the actual costs of $1,467,033,460 and the GCIM benchmark market index of $1,506,037,786; (b) the total savings was confirmed as follows: to ratepayers $32,685,515; to shareholders of SoCalGas, $6,318,811…." (ORA, Monitoring and Evaluation Report, p. 2-1.)

As identified in the January 15, 2004 Scoping Memo and Ruling, two issues have been raised in this proceeding. The first issue is whether SoCalGas should be awarded the amount it is requesting in its Year Nine application. The second issue is whether the GCIM created perverse incentives for SoCalGas and

San Diego Gas & Electric Company to manipulate gas prices, and if so, whether the GCIM should be modified or eliminated.

With regard to the first issue, SCE and ORA do not dispute the calculation of SoCalGas' request for a shareholder award of $6,318,811 for Year Nine. Although SCE has raised concerns about the GCIM structure, SCE does not challenge the manner in which the shareholder award for SoCalGas was calculated. ORA's Monitoring and Evaluation Report verified that the amount and calculation of the shareholder award amount for Year Nine is correct.

The second issue about whether the GCIM created perverse incentives is being addressed in I.02-11-040. If we determine in that investigation that SoCalGas' conduct led it to increase or manipulate gas prices at the California border because of the alleged perverse incentives, we may modify or eliminate the GCIM. The outcome of this issue in I.02-11-040 could affect the shareholder award amount that SoCalGas is seeking in this proceeding.

In D.03-08-065 and D.03-08-064, we found that SoCalGas reasonably managed its gas acquisitions and operations for Year Seven and Year Eight, respectively, within the context of the GCIM that existed at the time. We concluded in those two decisions that SoCalGas should be awarded the shareholder awards that it was seeking, subject to refund or adjustment as may be determined in I.02-11-040. A similar result should apply to SoCalGas' Year Nine application.

After reviewing SoCalGas' application and ORA's Monitoring and Evaluation Report for Year Nine, we find that SoCalGas reasonably managed its gas acquisitions and operations in Year Nine within the context of the GCIM that existed at the time. However, since we are conducting an investigation into the causes of high gas border prices from March 2000 through May 2001, today's

finding does not prejudge what we may find or conclude in I.02-11-040 regarding the GCIM.

We also find that the calculation and amount of SoCalGas' shareholder award for Year Nine is correct. In accordance with the GCIM modifications adopted in D.02-06-023, SoCalGas is entitled to a shareholder award of $6,318,811 for Year Nine of the GCIM. However, due to the ongoing activities in I.02-11-040, we may adjust the shareholder award for Year Nine if we decide in that investigation that the GCIM that SoCalGas operated under during Year Nine should be modified or eliminated.

Thus, we will award SoCalGas a shareholder award of $6,318,811 for Year Nine of its GCIM, subject however to refund or adjustment, as may be determined in I.02-11-040. SoCalGas is permitted to adjust the Purchased Gas Account to reflect the shareholder award that may be subject to refund or adjustment.

IV. Comments on Draft Decision

The draft decision of the Administrative Law Judge (ALJ) in this matter was mailed to the parties in accordance with Public Utilities Code § 311(g)(1) and Rule 77.7 of the Rules of Practice and Procedure. Opening comments were filed on ____, and reply comments were filed on ____.

V. Assignment of Proceeding

Susan P. Kennedy is the Assigned Commissioner, and John S. Wong is the assigned ALJ in this proceeding.

Findings of Fact

1. The GCIM provides an incentive for SoCalGas to purchase gas at or below the benchmark, and savings below the tolerance band are shared with ratepayers and SoCalGas' shareholders according to the sharing band.

2. The GCIM was modified in D.02-06-023, and SoCalGas was authorized to continue the use of the GCIM on an annual basis until modified or terminated by the Commission.

3. The January 15, 2004 Scoping Memo and Ruling determined that no evidentiary hearings were needed, but a hearing may be needed in the future depending on the outcome in I.02-11-040 and if the Commission decides to modify or eliminate the GCIM on a retroactive basis.

4. The GCIM is designed to provide SoCalGas with a financial incentive for making efficient gas purchasing decisions.

5. SoCalGas acquired gas at a savings of $39,004,326 below the GCIM benchmark in Year Nine.

6. Although SCE has raised concerns about the GCIM structure, SCE does not challenge the manner in which the shareholder award for SoCalGas was calculated.

7. ORA's Monitoring and Evaluation Report for Year Nine verified the amount and calculation of the shareholder award.

8. The issue about whether the GCIM created perverse incentives is being addressed in I.02-11-040.

9. I.02-11-040 states that the Commission may modify or eliminate the GCIM, and the outcome of the perverse incentives issue in that proceeding could affect the shareholder award amount that SoCalGas is seeking in this proceeding.

10. SoCalGas reasonably managed its gas acquisitions and operations in Year Nine within the context of the GCIM that existed at the time.

11. The calculation and amount of SoCalGas' shareholder award for Year Nine are correct.

Conclusions of Law

1. Today's finding regarding the reasonableness of SoCalGas' management of its gas acquisitions and operations in Year Nine shall not prejudge what the Commission may find or conclude in I.02-11-040.

2. In accordance with the GCIM modifications adopted in D.02-06-023, SoCalGas is entitled to a shareholder award of $6,318,811 for Year Nine of the GCIM.

3. Due to the ongoing activities in I.02-11-040, the Commission may adjust the shareholder award for Year Nine if the Commission decides in that investigation that the GCIM that SoCalGas operated under during Year Nine should be modified or eliminated.

4. SoCalGas should be awarded a shareholder award of $6,318,811 for Year Nine of its GCIM, subject however to refund or adjustment, as may be determined in I.02-11-040.

5. SoCalGas should be permitted to adjust the Purchased Gas Account to reflect the shareholder award of $6,318,811 that may be subject to refund or adjustment.

O R D E R

IT IS ORDERED that:

1. Southern California Gas Company (SoCalGas) is authorized to adjust the Purchased Gas Account to recognize a shareholder award of $6,318,811 under Year Nine of its Gas Cost Incentive Mechanism.

2. SoCalGas's shareholder award amount of $6,318,811 shall be subject to refund or adjustment as may be determined by the Commission in Order Instituting Investigation 02-11-040.

3. This proceeding is closed.

This order is effective today.

Dated _____, at San Francisco, California.