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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Item 14
I.D. # 12125

ENERGY DIVISION **RESOLUTION G-3480**
June 27, 2013

R E S O L U T I O N

Resolution G-3480. Southern California Gas Company (SoCal Gas) submits its Annual Compliance Report (ACR) to demonstrate that gas procurement activities to maintain Southern System reliability were in compliance with the standards, criteria and procedures described in Rule 41 of its tariffs.

PROPOSED OUTCOME: This Resolution approves the submitted cost of the procurement activities attributable to all of the sales transactions. Two of the 115 purchase transactions do not meet the conditions specified for such purchases under Gas Rule 41 and therefore cannot be determined as reasonable. SoCalGas must provide adequate documentation and a narrative explanation via a supplemental advice letter to have the costs of these two purchases reviewed for potential approval.

SAFETY CONSIDERATIONS: This resolution evaluates activities to maintain system reliability. These activities have an indirect impact on safety since they are taken to avoid curtailments to customers some of whom may provide essential services.

ESTIMATED COST: $22,449,505

By Advice Letter 4406 filed on September 28, 2012

SUMMARY

SoCalGas submitted AL 4406 on September 28, 2012 in compliance with D.09-11-006 and Rule 41, providing an Annual Compliance Report (ACR) for the period September 1, 2011 through August 31, 2012. **This resolution approves the submitted costs of the procurement activities attributable to all of the sales and all but two of the purchase transactions made by SoCalGas to maintain Southern System minimum flow requirements.**

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All of the sales transactions met the requirements under Section 13 of Gas Rule 41. As such these transactions are considered to be reasonable. There were 115 purchase transactions. Of these, 113 met the requirements of either Section 13 or Section 14 of Rule 41 and are therefore considered reasonable and approved. Two purchases, representing $530,140 meet neither the Section 13 nor 14 requirements. SoCalGas has not provided sufficient information to demonstrate that these two transactions are reasonable under Section 15 of Rule 41. Therefore these two transactions are not approved. SoCalGas is required to submit, for further review by the Energy Division, a Supplemental Advice Letter, Advice Letter 4406-A, providing additional information and explanation concerning these two transactions.

There are incorrect statements in the text of the Advice Letter 4406. SoCalGas is required to incorporate corrections to these statements when it submits Supplemental Advice Letter 4406-A.

BACKGROUND

The SoCal Gas Southern System requires a minimum amount (which can vary depending on conditions) of flowing supplies to operate effectively. When deliveries into the southern part of the SoCalGas gas transmission system (the Southern System) become too low, it is difficult to efficiently and safely operate and assure deliveries to customers. The SoCalGas Gas Acquisition Department had previously assured such flowing supplies, using core customer assets.

Decision (D.) 07-12-019 approved the transfer of responsibility for managing minimum flow requirements for system reliability from the SoCalGas Gas Acquisition Department (GA) to the Utility System Operator (SO). As required by D.07-12-019, the SoCalGas SO took over the responsibility for managing these minimum flows as of April 1, 2009.[1] D.07-12-019 also approved the following System Operator tools for meeting Southern System requirements:

- the ability of the SO to buy and sell gas on a spot basis, as needed, to maintain system reliability;

[1] As stated in Rule 41, the mission of the Utility System Operator is to maintain system reliability and integrity while minimizing costs at all times. The Utility System Operator denotes all of the applicable departments within SoCalGas and San Diego Gas & Electric Company responsible for the physical and commercial operation of the pipeline and storage systems specifically excluding the Utility Gas Procurement Department.

- authority and the requirement to conduct at least one annual request for offers (RFO) or open season process consistent with the SO needs; and
- authority to approve (sic) an expedited Advice Letter approval process for contracts that result from an RFO or open season process.

Pursuant to D.09-11-006, SoCalGas must submit an Annual Compliance Report to demonstrate that its natural gas procurement activities undertaken to support Southern System reliability were in compliance with certain standards, criteria and procedures. In D.09-11-006, the Commission adopted a Settlement Agreement in Phase 2 of the SoCalGas/SDG&E 2009 Biennial Cost Allocation Proceeding (BCAP). Under that Settlement Agreement, and as specified in Rule 41 of SoCalGas' tariff, SoCalGas must submit an Annual Compliance Report to the Commission to demonstrate that the "Operational Hub"[2] gas procurement activities during the preceding twelve months were in compliance with the standards, criteria and procedures that are described in Sections 9 through 17 of Rule 41. The Annual Compliance Report must be submitted by Advice Letter.

In AL 4406, filed on September 28, 2012, SoCalGas asserts that its gas procurement activities to maintain Southern System reliability during the twelve months September 1, 2011 through August 31, 2012 were in compliance with the standards, criteria and procedures specified in Sections 9 through 17 of Gas Rule 41. During this period, SoCalGas reports gas purchase costs of $22.450 million to meet Southern System minimum flow requirements. All of this gas was acquired using spot purchases. An additional $335,944 in transportation costs were incurred.[3] The gas was then reported as resold at the SoCal Citygate for $20.594 million, yielding a net cost, including transportation costs, of $2.192 million. SoCalGas Rule 41 specifies detailed criteria and processes for reasonable spot gas purchases and sales made by the Operational Hub. SoCalGas asserts that all sales and most purchases were within the automatic safe harbor price

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[2] The SoCal Gas Operational Hub is a component of the SoCalGas System Operator. The Operational Hub conducts the activities involved in meeting any physical flowing supply requirements as determined by the Gas Control Department. The Gas Control Department is the SoCalGas unit responsible for operating the utility pipeline and storage system.

[3] Backbone Transportation Charges equaled $242,925. Transportation charges for delivery of gas to Otay Mesa added $93,019 for the total of $335,944.

limits described in Section 13 of the rule and that the remainder met the requirements of Section 14. SoCalGas asserts that it has met the criteria and followed the necessary processes for reasonable spot gas purchases and sales detailed in Rule 41.

NOTICE

Notice of AL 4406 was made by publication in the Commission's Daily Calendar. SoCalGas states that a copy of the Advice Letter was sent to the parties listed on Attachment A of AL 4406, which includes parties to Application 08-02-001.

PROTESTS

Advice Letter 4406 was not protested.

DISCUSSION

The Commission approves all of the sales and 113 of the 115 purchases presented in AL 4406. Contrary to the SoCalGas assertion that all of the transactions met either Section 13 or 14 requirements, two purchase transactions representing 2.4% of total dollar purchases were not categorized as Section 13 or 14 in Attachment C to the AL and do not meet the requirements of either of these Sections. In both the current report and the report for the period September 1, 2010 through August 31, 2011, transactions have been misclassified as falling under Section 13 or 14, while not meeting the clearly defined criteria of these sections. Further, the two purchase transactions that do not meet Section 13 or 14 requirements lack sufficient documentation to be deemed reasonable under Section 15 of Rule 41.

Rule 41 specifies the criteria for determining if the net cost of spot gas purchases/sales was incurred reasonably. All spot gas purchases and sales must be made only when the Operational Hub is the "provider of last resort", i.e., when the Operational Hub has used all other available tools to meet the minimum supply requirements.

Section 13 of the rule states that the purchases and sales must be within a specified range (+/- 10%) of the Intercontinental Exchange (ICE) price index. For purchases and sales made outside the specified range, Section 14 requires that if volumes available on ICE meet or exceed the minimum flow requirements, transactions for the volumes offered through ICE shall be deemed reasonable.

Under Section 14, when less than the required volumes are available on ICE, offers from at least three differing suppliers will be obtained for comparison. Based on these offers, SoCalGas will accept the offers with the best prices available to meet the quantities required. Further, if Section 14 procedures are not met, Section 15 states that purchases will not be deemed unreasonable but shall be subject to review and any requests for explanation by the Commission's Energy Division in conjunction with the Annual Compliance Report.

The procurement costs of $22,449,505 incurred by the SoCalGas Operational Hub between September 1, 2011 and August 31, 2012 were entirely from 115 spot purchases.[4] Contrary to SoCalGas statements, most of the purchases were not made within the automatic safe harbor price limits of Section 13. Of the 115 purchases, 60 transactions (representing 52% of the total purchase transactions), were made outside of the Section 13 safe harbor price limits but within the criteria called for under Section 14. These Section 14 purchases represent approximately 49% of the dollar purchases. 53 purchases, representing just under 46% of the transactions fell within the safe harbor limits of Section 13. Section 13 purchases represented a slightly lower percent of the dollar amount of purchases than those made under Section 14. A review of Attachment C to the AL indicates that SoCalGas shows two purchases, representing the remaining 2% of transactions and 2.4% of dollar purchases, not classified as falling under Section 13 or 14.

[4] SoCalGas Advice Letter 4406, September 28, 2012, Attachments C and F. The count of 115 purchases is based on separate transactions to which the ACR has assigned separate TC numbers and reported separately. (TC numbers are tracking numbers assigned by SoCalGas to each SO purchase or sale.)

The table below presents the breakdown.

	Number/%	$*/%
Section 13 Purchases	53/46%	$10.940/48.7%
Section 14 Purchases	60/52%	$10.980/48.9%
Other	2/ 2%	$.530/ 2.4%
TOTAL	**115/100%**	**$22.450/ 100.0%**

*$ in Thousands

As indicated above, two transactions did not meet the criteria for reasonableness specified in Sections 13 and 14 of Rule 41. Section 15 allows for transactions made outside of the Section 14 process to be deemed reasonable when supported with sufficient explanations. In the AL and subsequent responses to data requests SoCalGas failed to provide sufficient explanations and documented support to deem these two purchase transactions reasonable.

SoCalGas states, in regard to purchases not meeting the requirements of Section 13 of Rule 41, that these "other purchases were made by directly contacting three or more suppliers for offers per Section 14."[5] This assertion, in conjunction with the prior assertion that purchases were in compliance with the standards, criteria and procedures of Sections 9 through 17 of Rule 41, indicates that SoCalGas incorrectly interprets the requirements of Section 14. There are two Section 14 requirements. The first of these is ensuring that "at least *three offers* from three different suppliers are available for comparison."(emphasis added).[6] This criterion is independent of the number of contacts needed to obtain three offers and making three or more contacts without receiving the required number of offers is not sufficient under the Section. Second, Section 14 requires that "the Operational Hub shall compare prices posted on ICE and, if applicable, prices quoted by its supplier contacts, and *select the best prices* available to meet the quantities required to meet minimum flow requirements."(emphasis added)[7]

[5] Ibid., p.2.

[6] Southern California Gas Company Rule No. 41, PURCHASES AND SALES TO MANAGE MINIMUM FLOW SUPPLIES, Section 14, CAL. P.U.C. SHEET NO. 48308-G.

[7] Ibid., CAL. P.U.C. SHEET NO. 48308-G.

SoCalGas has two purchases that do not meet Section 13 requirements and meet one but not both of the Section 14 requirements. Further there is insufficient information to determine if these two purchases are reasonable under Section 15.

The purchase designated as TC# 947 does not meet Section 13 requirements and fails to meet one of the two Section 14 requirements. SoCalGas did not select the best prices in making this transaction. When notified on 12/5/11 of the minimum flow requirements for 12/6/2011 SoCalGas made a purchase, in the amount of 73,140 dth with a purchase price of $4.36 per dth for a total price of $318,890. The purchase represents the second lowest price of three offers.[8] As such it falls outside of Section 14. The text of the advice letter did not identify this transaction as outside of Section 14. However, in Attachment C (and in the confidential version of Attachment C, Attachment F) which details each purchase and sale SoCalGas entered a note concerning the transaction. The note stated that "Three offers were received. The low cost supplier could only provide about 15,000 dth but he was not sure if delivery was firm. We chose to go with the second lowest offer for firm delivery."[9] Given this, the purchase does not meet the Section 14 requirement that SoCalGas will accept the offers with best prices available. The AL provides no additional information concerning why there was concern about whether the delivery was firm, if additional offers were made, etc. In response to a data request from Energy Division Staff (Staff) SoCalGas replied that the lowest cost supplier expressed a concern about well freeze-ups in the San Juan basin. The reply further stated that parties other than those whom SoCal Gas received offers from, did not have significant firm pipeline capacity and that interruptible capacity was costing 250% of the firm rate equating to $1/dth for transportation to Ehrenberg.[10] Staff made a second, follow up request for additional information, in particular for information concerning the comments about San Juan basin freeze offs as expressed by the lowest cost supplier and the circumstances related to the freeze offs. SoCalGas replied that other higher cost

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[8] SoCalGas Advice Letter 4406, September 28, 2012, p. 2.

[9] AL 4406, Attachments A and F, purchase transaction designated as TC#947 for flow date of 12/6/2012.

[10] Ehrenberg, at the eastern end of the SoCalGas Southern System is the primary Southern System supply delivery point.

suppliers were available and that the "freeze up concern" was one expressed by the lowest cost supplier. The reply further commented that SoCalGas did "not have written documentation concerning widespread well freeze offs on that day." While SoCalGas was unable to provide information confirming or denying the concerns of the lowest cost supplier, Staff, with limited effort, was able to gather data for the San Juan basin concerning weather conditions as well as production levels specific to the flow date and the period immediately before and after the flow date; and, supply relative to demand for the regions served by the basin. **The somewhat limited information provided by SoCalGas, after multiple data requests, does suggest that there were supply issues. However, SoCalGas failed to provide information to confirm or deny that suggestion and provide an adequate context for its decision to use other than the lowest cost supplier. Staff's research indicates that significant information to fully meet its data request is available.**

The purchase designated as TC# 1089 does not meet Section 13 requirements and fails to meet both of the Section 14 requirements. This transaction was made without obtaining three offers. Attachments C and F report a purchase of 64,887 dths for a flow date of 2/27/12 and a total price of $211,250. Similar to the purchase related to flow date of 12/6/11, discussed above, this transaction was not shown in Attachment C or F as meeting Section 13 or 14. Rather, a note was provided. The note explains that while three calls for offers were made only two quotes were received. The note further states that based on a *scarcity of supply* a decision was made to execute based on the two offers rather than risk losing the supply in hand while waiting for a third offer.[11] No additional information was provided. In reply to an Energy Division data request, SoCalGas essentially repeated the information provided in the note to Attachments C and F with some additional details. The reply noted that a call for supplies was received on Sunday morning (cycle 2) for flowing supplies on Monday and that "only four parties…had low-cost supplies over this period because they were the only parties with significant firm El Paso transportation contracts. We executed with [two parties] and received a non-price quote from a third party. We simply could not reach the fourth reliable supplier on a Sunday morning in order to

[11] AL 4406, Attachments C and F, purchase transaction designated as TC# 1089 for flow date 2/27/12.

obtain a third price quote."[12] The Energy Division requested further explanation asking the cause of the "scarcity of supply" and the cause of a cycle 2 request for Monday flowing supplies. In reply, SoCalGas stated that "The scarcity of supply is perhaps a misnomer. It is simply difficult to reach any traders with any suppliers on a Sunday morning in order to buy incremental supply."[13] The reply continued that "Cycle 2 requests for Monday are unusual, but the cycle 2 southern system minimums provided by the Operator jumped from 455,000 dths for flow day Feb 26 to 687,000 dths on flow day Feb 27. The minimum increased in large part due to cold weather, a mean of 48 degrees per Envoy (SoCalGas' electronic bulletin board) on the 27th versus 51 degrees per Envoy on the 26th. The 27th was the coldest day of February."[14]

The replies to the data request assert that it was "difficult" to reach suppliers, however, there is nothing to substantiate this assertion. There is no statement that more than three calls were made and if so how many and over what time frame. Further, the reply to the second request stating that a "scarcity of supply is perhaps a misnomer" contradicts the statements in the notes of Attachment A and F of the AL, and the reply to Staff's first data request concerning the purchase. While information is provided concerning weather conditions, it is not clear whether this resulted in a scarcity of supply or if the reason for the transaction was because of a stated difficulty in reaching suppliers. **The limited information provided by SoCalGas for transaction designated as TC# 1089 suggests that there may be reasons for the transaction to be approved under Section 15 of Rule 41. However, after multiple data requests SoCalGas has not provided sufficient information to determine if this transaction should be approved.**

Corrections are required to the text submitted in AL 4406 and the Commission is requiring that these corrections be provided in a Supplemental Advice Letter labeled 4406-A. In that supplement SoCalGas may provide additional information that would support upon review by the Energy Division, the Commission approving the transactions numbered TC#947 and TC#1089 under

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[12] January 9, 2013 reply to Energy Division data request 1 and 2 of January 2, 2013. Names of parties confidential.

[13] Data requests concerning ACR/AL 4406, March 1, 2013, pp. 1-2.

[14] Ibid., p.2.

Section 15 of Rule 41. In addition, future ACRs should include a narrative and a table presenting the number and percentages of transactions by the appropriate Section of Rule 41 under which SoCalGas asserts the transactions to be reasonable. A narrative explanation for any transaction not meeting the requirements of Sections 13 and 14 should be included in any future ACR, and supplemented with additional exhibits and documentation as appropriate.

COMMENTS

Public Utilities Code section 311(g)(1) provides that the draft of this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, the draft resolution was mailed to parties for comments on May 15, 2013.

SoCalGas submitted comments on June 17, 2013. SoCalGas states that it supports the Draft Resolution as written, and does not recommend any changes.

FINDINGS AND CONCLUSIONS

1. Pursuant to D.09-11-006 and Rule 41, SoCalGas must submit an Annual Compliance Report by October 1st to demonstrate that its natural gas procurement activities undertaken to support Southern System reliability were in compliance with certain standards, criteria and procedures.
2. SoCalGas submitted, in compliance with D.09-11-006 and Rule 41, AL 4406 on September 28, 2012 providing an Annual Compliance Report for the period September 1, 2011 through August 31, 2012.
3. SoCalGas incurred $22.450 million in procurement transaction costs to support Southern System reliability between September 1, 2011 and August 31, 2012.
4. All of the procurement costs were incurred through 115 spot purchase transactions.
5. The Operational Hub made gas sales that resulted in a net cost of $2,191,549.
6. SoCalGas incorrectly states that all of the purchases and all of the sales presented in AL 4406 met the requirements to be considered reasonable as

defined by Sections 13 and 14 of Rule 41. Further it incorrectly states that most purchases were made within the requirements of Section 13.

7. All of the sales transactions met the requirements to be presumed reasonable under Rule 41 and are approved.

8. Fifty three of the 115 purchase transactions representing $10,940,000, or 48.7% of the total gas purchases, were made through transactions falling within the range of prices specified in Section 13 of Rule 41 and are therefore presumed to be reasonable and are approved.

9. Most of total gas purchases (60 of the 115 purchase transactions representing $10,980,000 or 48.9%), were made through transactions with prices outside the range of prices specified in Section 13 of Rule 41 for presumed reasonable transactions. However, these transactions met the requirements of Section 14 of the Rule and are reasonable and approved.

10. Two purchase transactions totaling $530,140 and designated as TC#947 and TC#1089 do not meet the requirements of Sections 13 or 14 of Rule 41.

11. Rule 41, Section 15, provides that purchases that do not meet the requirements of Section 14 are not to be deemed unreasonable but shall be subject to review and any requests for explanation by the Commission's Energy Division.

12. SoCalGas did not provide sufficient information and explanation in the Advice Letter nor in replies to multiple data requests for the Energy Division to determine if TC#947 and TC#1089 are reasonable under Section 15 and as such these transactions are not approved.

13. SoCalGas should submit a supplemental Advice Letter numbered 4406-A correcting errors regarding the number of purchases meeting Section 13 requirements, the number meeting Section 14 requirements and the number to be considered under Section 15.

14. SoCalGas should include in Advice Letter 4406-A further explanation for those transactions not yet approved. The Energy Division should review any additional information provided and determine if the transactions should be approved.

15. Both the ACR presented in Advice Letter 4406 and the most recent prior ACR presented in Advice Letter 4282 contained errors in how transactions were represented vis-à-vis their reasonableness under Sections 13 and 14 of Rule 41. To reduce the potential for additional errors, future ACRs should include a

narrative statement and a table in the text of the report presenting the number and percents of transactions by the Section of Rule 41 under which SoCalGas asserts the transactions to be reasonable. A narrative explanation for any transaction not meeting the requirements of Sections 13 and 14 should be included in any future ACR, and supplemented with additional exhibits and documentation as appropriate.

THEREFORE IT IS ORDERED THAT:

1. All sales transactions and all purchase transactions excepting TC# 947 for flow date December 6, 2011 and TC# 1089 for flow date February 27, 2012 are considered reasonable, are approved and, per Section 24 of Rule 41, shall be amortized in customer transportation rates over the following year.
2. Purchase transaction TC#947 and TC#1089 are not deemed to be reasonable and shall not be amortized in customer transportation rates unless and until determined to be reasonable by the Commission upon review by the Energy Division of additional supporting information and documentation.
3. SoCalGas shall prepare and submit, within 30 days of this Resolution a supplemental Advice Letter numbered 4406-A which:
   (a) Corrects statements concerning purchase transactions meeting the requirements of Sections 13 or 14 of Rule 41 and accurately identifies the two transactions not meeting the requirements of these sections. As part of these corrections SoCalGas shall state the reasons that these transactions do not meet the requirements of Sections 13 or 14.
   (b) Incorporates a table, in the text of the ACR, that presents the number and percent of transactions and the corresponding dollar amount and percent of total dollars that SoCalGas asserts are reasonable by nature of having met the requirements of Rule 41.
   (c) Provide additional information concerning transactions TC#947 and TC#1089 and a supporting explanation, included in the text of the ACR, of whether and why these transactions should be approved under Section 15 of Rule 41.
4. The Energy Division shall review and evaluate Supplemental Advice Letter 4406-A and determine if transactions TC#947 and TC#1089 are sufficiently supported to be approved as reasonable according to Section 15 of Rule 41.
5. SoCalGas shall incorporate, in all future ACRs, a table, as described in ordering paragraph 3.(b) and narrative explanations supported by

appropriate documentation for any transactions to be evaluated as reasonable under Section 15 of Rule 41.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on June 27, 2013 the following Commissioners voting favorably thereon:

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Paul Clanon
Executive Director