



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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Order Instituting Rulemaking to Address the Gas Utilities' Incentive Mechanisms and the Treatment of Hedging Under Those Incentive Mechanisms.

Rulemaking 08-06-025
(Filed June 26, 2008)

**REPLY COMMENTS OF
THE DIVISION OF RATEPAYER ADVOCATES IN RESPONSE TO THE
ADMINISTRATIVE LAW JUDGE'S JANUARY 15, 2009 RULING**

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March 13, 2009

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I. INTRODUCTION

Pursuant to the January 15, 2009 and January 21, 2009 and Administrative Law Judge's Rulings, the Division of Ratepayer Advocates (DRA) hereby files its Reply Comments on the additional issues described in the ALJ Ruling. In this Reply, DRA briefly addresses the Opening Comments of SoCalGas, Shell and TURN.¹ In its Opening Comments DRA indicated that it is amenable to the inclusion of a minimum 25% of the cost of winter hedging within the utilities' gas procurement incentive mechanisms, with ratepayers being responsible for the lower of 75% of the hedging outcome or \$10 million. DRA maintains that this would be a good Commission hedging policy.

II. DISCUSSION

A. SoCalGas's Proposed Hedging Benchmark

DRA has reviewed SoCalGas' Opening Comments and disagrees with SoCalGas' proposed hedging benchmark and its accompanying caveats. SoCalGas' proposed hedging benchmark is patently flawed and is illogical. DRA maintains that the pursuit of this concept is both a waste of the Commission's resources and an invitation to utilities to devise new ways to alter the risk-reward paradigm in their favor with no ratepayer benefits. DRA agrees with PG&E's open recognition of the futility of devising such a hedging benchmark. In its Opening Comments, PG&E states that "such an approach or standard (would be) difficult to construct and

¹ In these Reply Comments, DRA uses the term "Opening Comments" only to refer to Comments served in this proceeding on February 20, 2009 and does not reference prior rounds of Comments in this docket.

would likely lack sufficient transparency to adequately monitor and audit.” *See* PG&E Opening Comments at 4. DRA recommends against the adoption of any type of hedging benchmark.

DRA strongly disagrees with SoCalGas’ suggestion that Commission oversight would ensure that its mechanism would be beneficially designed and executed. SCG states, “Moreover, because SoCalGas’ winter hedging transactions are included within trading plans that are pre-reviewed and preapproved by the Commission each year, the Commission will still maintain a strong level of oversight over such transactions.” *See* SoCalGas Opening Comments at 13. It is interesting to note that SoCalGas still seeks a pre-review and pre-approval that, in DRA’s opinion, would insulate SoCalGas of any future allegations of gaming a hedging benchmark that it concocted. If the Commission pre-reviews and pre-approves the hedging plan, then where is the wisdom in rewarding SoCalGas for its hedging performance or in the development of a hedging benchmark? DRA does not believe that the Commission has the resources to dedicate to such microscopic oversight as SoCalGas suggests. After all, to DRA’s knowledge, the Commission, to date, has not dedicated any resources to reviewing utilities’ hedging performance on the electric side. Therefore, there is no reason that the Commission has the inclination to provide the insulation and policing that SoCalGas seeks while SoCalGas is busy earning a hedging reward through its self-designed benchmark. Besides, such policing would take the Commission backwards to the era of reasonableness reviews. Placing hedging back inside the incentive mechanisms, as consistently recommended by DRA, is a self-policing approach that will relieve the Commission of the task of policing and reviewing the utilities hedging transactions after the fact.

B. Shell Energy’s Opening Comments

In DRA’s earlier comments, DRA pointed out that, aside from hand-waving assertions, no party provided any evidence on the record to show that price volatility in the natural gas market has been any higher than before, or that price volatility is even a problem. Nonetheless, Shell continues to presume that volatility in the natural gas markets is a problem, and believes that it has a solution. Nowhere in its proposal does Shell indicate just how its proposal to reduce this presumed high volatility would benefit ratepayers. Shell’s proposal has no merit.

C. TURN’s Opening Comments

TURN, in voicing its opposition to hedging benefits or losses within the gas procurement incentive mechanisms, states, “we are concerned about promoting a system

that penalizes the utilities when gas prices fall, as this creates an inherent conflict between shareholder and ratepayer interests and creates a disincentive to engage in hedging.” See TURN Opening Comments at 4. TURN’s observation is inaccurate. First, hedging inside the procurement incentive mechanisms, as advocated by DRA, allows both the utility (and ratepayers) to profit from falling gas prices because utilities can either buy puts or sell short in the gas markets depending on the opportunities in the markets. Utilities therefore have the incentive to hedge wisely when hedging is performed inside the incentive mechanisms. Conversely, utilities have no incentive to hedge wisely outside their incentive mechanisms because shareholders have nothing at stake and therefore nothing to lose. In this instance, shareholder and ratepayer interests are at odds, with ratepayers losing staggering amounts, as has been the case since the days of Hurricane Katrina. Hedging inside the gas incentive mechanisms will therefore addresses TURN’s concerns by ensuring that both ratepayers and shareholders benefit from falling prices, and ratepayers’ and shareholders’ interests are not at odds.

Respectfully submitted,

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March 13, 2009

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of **REPLY
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Executed on March 13, 2009 at San Francisco, California.

/s/ ALBERT HILL
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