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Decision 08-12-020 December 4, 2008

**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 Revise Their Rates Effective January 1, 2009, in Their Biennial Cost Allocation Proceeding.

Application 08-02-001  
(Filed February 4, 2008)

**DECISION REGARDING THE PHASE ONE ISSUES  
AND THE MOTION TO ADOPT THE SETTLEMENT AGREEMENT**

**TABLE OF CONTENTS**

<b>Title</b>	<b>Page</b>
<b>DECISION REGARDING THE PHASE ONE ISSUES AND THE MOTION TO ADOPT THE SETTLEMENT AGREEMENT .....</b>	<b>2</b>
1. Summary .....	2
2. Background .....	3
3. Discussion .....	5
3.1. Overview of the Phase One Issues .....	5
3.2. The Settlement Agreement’s Proposed Recommendations .....	6
3.3. Should the Proposed Settlement Agreement Be Adopted? .....	10
3.3.1. Combined Core Storage.....	11
3.3.2. Wholesale Core Customers .....	12
3.3.3. Total Storage Capacity and the Unbundled Storage Program .....	16
3.3.4. Treatment of Unbundled Storage Revenues and Hub Revenues .....	19
3.3.5. Balancing.....	22
3.3.6. Prices for Storage Services.....	24
3.3.7. Future Storage Expansions.....	25
3.3.8. Storage Accounts .....	27
3.3.8.1. NSMA .....	27
3.3.8.2. SDGE SMA.....	29
3.4. Conclusion .....	30
4. Comments on Proposed Decision .....	31
5. Assignment of Proceeding.....	31
Findings of Fact .....	32
Conclusions of Law .....	33
ORDER .....	34
ATTACHMENT 1 - Settlement Agreement	

**DECISION REGARDING THE PHASE ONE ISSUES  
AND THE MOTION TO ADOPT THE SETTLEMENT AGREEMENT**

**1. Summary**

This decision addresses the Phase One issues in the cost allocation proceeding filed by San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) regarding their natural gas transmission and storage services.

Following the close of evidentiary hearings in Phase One, SDG&E, SoCalGas, and nine other parties filed a joint motion “For Adoption of Settlement Agreement and Immediate Suspension of Briefing Schedule for Phase One Issues” (motion to adopt the Settlement Agreement).<sup>1</sup> The Settlement Agreement addresses all of the Phase One issues, and the balancing issues that were to be addressed in Phase Two.

Today’s decision grants the motion to adopt the Settlement Agreement and the terms of the Settlement Agreement are adopted. The Settlement Agreement’s balancing of the various interests of the different parties will ensure that core and noncore customers in southern California will have sufficient storage services during the term of the Settlement Agreement, while providing monetary incentives to SDG&E and SoCalGas to encourage them to expand the storage assets for the unbundled storage program. Among other things, the Settlement Agreement resolves the total amount of gas storage inventory, storage injection, and storage withdrawal capacities that will be made available for balancing purposes and to the core and noncore customers in southern California over the six-year term of the Settlement Agreement. The

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<sup>1</sup> The Settlement Agreement was attached to the joint motion as Appendix A, and is attached to this decision as Attachment 1.

Settlement Agreement provides that the wholesale core customers will pay for the storage services at the same rates that the combined core customers of SDG&E and SoCalGas pay.

The Settlement Agreement also resolves the sharing mechanism that ratepayers and shareholders will use to allocate the net revenues from the sales of unbundled storage revenues and from hub services. The Settlement Agreement also provides that any future expansion of the storage assets for the unbundled storage program will be subject to this sharing mechanism as well.

The various provisions of the Settlement Agreement are discussed in more detail in Sections 3.2. and 3.3. of this decision.

## **2. Background**

In accordance with Ordering Paragraph 10 in Decision (D.) 06-12-031, SDG&E and SoCalGas filed the above-captioned application on February 4, 2008. This is the first cost allocation proceeding for both utilities since D.00-04-060 adjudicated the Biennial Cost Allocation Proceeding (BCAP) applications of SDG&E and SoCalGas that were filed in October 1998 in A.98-10-012 and A.98-10-031.<sup>2</sup>

Protests and responses to the application were filed by the City of Long Beach (Long Beach), Coral Energy Resources, L.P.,<sup>3</sup> Division of Ratepayer Advocates (DRA), Indicated Producers, Pacific Gas and Electric Company, Southern California Edison Company (SCE), Southern California Generation Coalition (SCGC), The Utility Reform Network, Watson Cogeneration Company and the California Cogeneration Council, and the Western

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<sup>2</sup> Subsequent BCAP applications were filed by SDG&E and SoCalGas, but due to other proceedings, those BCAP applications were dismissed in D.03-05-050 and D.04-05-039.

<sup>3</sup> Coral Energy Resources was merged into its parent company, and is now referred to as Shell Energy North America (US), L.P. (Shell Energy).

Manufactured Housing Community Association. SDG&E and SoCalGas filed a reply to the protests and responses on March 17, 2008.

A prehearing conference (PHC) to discuss the issues and procedural schedule for this proceeding was held on April 3, 2008. Following the PHC, a Scoping Memo and Ruling (Scoping Memo) was issued on April 17, 2008. The Scoping Memo bifurcated the proceeding into two phases, and established a separate procedural schedule for each phase.

Five days of evidentiary hearings were held in July 2008 on the Phase One issues. Following the close of these hearings, the parties met to discuss the possible settlement of the Phase One issues. On August 22, 2008, SDG&E, SoCalGas, and nine other parties filed the motion to adopt the Settlement Agreement.

As part of the motion to adopt the Settlement Agreement, the moving parties requested that the briefing schedule for the Phase One issues be suspended. In an August 25, 2008 e-mail to the service list, which was confirmed in an August 29, 2008 ALJ ruling, the schedule for the filing of opening and reply briefs in Phase One was suspended. The e-mail and ruling also notified the parties of the filing dates for comments and reply comments on the motion to adopt the Settlement Agreement. No comments were filed.

A number of letters were received by the Commission's Public Advisor's office concerning the application of SDG&E and SoCalGas. All of the letters oppose any increase in the gas rates of the customers of SDG&E and SoCalGas. Many of the letters expressed the concern that food costs, gasoline, and utility rates have all gone up, while the incomes of the utilities' customers have remained the same or increased at a significantly slower rate than the price increases.

### **3. Discussion**

#### **3.1. Overview of the Phase One Issues**

In the April 17, 2008 scoping memo, the issues in this proceeding were bifurcated into two phases. The Phase One issues were identified in the scoping memo as follows:

1. Reservation of storage assets for the core (including wholesale core parity).
2. Obligation of SoCalGas to maximize the availability of storage for the unbundled storage program and the hub services program.
3. Allocation of unbundled storage revenues between shareholders and ratepayers.
4. Treatment of cost and revenues associated with storage expansion.
5. Interrelationship of cost-revenue treatment for existing unbundled storage and expanded storage.

All of the parties were provided with the opportunity to submit prepared testimony on the Phase One issues and to cross-examine the witnesses during the evidentiary hearings. Forty three documents were identified as exhibits during the hearings, of which 41 were received into evidence and official notice was taken of Exhibit 24.

In deciding whether the motion to adopt the Settlement Agreement should be granted or denied, we summarize the Settlement Agreement's proposed recommendations, and then discuss the litigation positions of the parties as compared to the Settlement Agreement.

### **3.2. The Settlement Agreement's Proposed Recommendations**

The Settlement Agreement was agreed to by SDG&E, SoCalGas, DRA, SCE, the Indicated Producers, SCGC, Long Beach, Southwest Gas Corporation (Southwest Gas), Watson Cogeneration Company, the California Cogeneration Council, and the California Manufacturers and Technology Association. Shell Energy, an active party to this proceeding, did not join in the Settlement Agreement, and did not file any comments on the motion to adopt the Settlement Agreement.

The Settlement Agreement, which is appended to this decision as Attachment 1, contains the recommendations of the settling parties regarding the Phase One issues, as well as some of the gas balancing issues that are in Phase Two. A summary of the key provisions of the Settlement Agreement are described below, and a detailed description of those provisions are discussed in Section 3.3. of this decision.

The Settlement Agreement is to be effective on January 1, 2009 or the date the Commission approves the Settlement Agreement, whichever is later. The term of the Settlement Agreement is for six years (from 2009-2014), and is to terminate on December 31, 2014.

The Settlement Agreement addresses the total amount of storage inventory capacity (131.1 billion cubic feet [Bcf]), storage injection capacity (850 million cubic feet per day [MMcfd]), and storage withdrawal capacity (3195 MMcfd) that SDG&E and SoCalGas will make available, using commercially reasonable efforts to do so, during the term of the Settlement Agreement. Of those capacities, the Settlement Agreement will initially allocate to the combined core customers of SDG&E and SoCalGas the following capacities: 79 Bcf of storage inventory; 369 MMcfd of storage injection with

annual increases to match the growth in inventory capacity up to a total of 388 MMcfd; and 2225 MMcfd of storage withdrawal. The annual cost of those storage capacities to the combined core customers of SDG&E and SoCalGas is to be at the Commission-adopted embedded unit costs that are established in Phase Two of this proceeding and as revised in each subsequent cost allocation proceeding filed with the Commission during the term of the settlement.

As to the remaining storage capacities, the Settlement Agreement will allocate the following capacities to the balancing function: 4.2 Bcf of storage inventory; 200 MMcfd of storage injection; and 340 MMcfd of storage withdrawal. The wholesale core customers, Long Beach and Southwest Gas, are also allocated a portion of the storage inventory, storage injection, and storage withdrawal as described in Paragraphs 12, 13 and 14 of the Settlement Agreement. The remaining amounts of storage inventory, storage injection, and storage withdrawal (approximately 45.71 Bcf, 270.8 MMcfd, and 554.3 MMcfd, respectively) will be available to the unbundled storage program as described in Paragraph 12 of the Settlement Agreement.

The Settlement Agreement also addresses the future expansion of the gas storage assets. In Paragraphs 6 and 7 of the Settlement Agreement, SoCalGas agrees to make commercially reasonable efforts to expand its storage inventory at its four existing storage fields by 7 Bcf over the period 2009-2014. Of the 7 Bcf of expanded storage inventory, 1 Bcf of the expanded capacity is to be added to the combined core's storage inventory capacity in each of the four years from 2010 to 2013. In each of the three years in 2010, 2012 and 2014, 1 Bcf of the expanded storage inventory capacity is to be added to the unbundled storage program.

In Paragraph 8 of the Settlement Agreement, SoCalGas agrees to expand the injection capacity at its Aliso Canyon storage facility through the replacement of three existing turbines at its Aliso Canyon storage facility and through expansion projects. This is expected to expand the injection capacity at Aliso Canyon by approximately 145 MMcfd. Paragraph 8 also describes how the cost of expanding the injection capacity will be added to SoCalGas' storage rate base, and how the associated increase in SoCalGas' revenue requirement will be allocated to the core, load balancing, and unbundled storage.

Paragraph 18 of the Settlement Agreement addresses the treatment of possible future storage expansions beyond the expansions described in Paragraph 6 and Paragraph 8 of the Settlement Agreement. These storage expansions are to be deemed as undertaken for the unbundled storage program. The revenues from any such expansions are to be included in the revenue sharing mechanism for the unbundled storage program as described in Paragraph 15 of the Settlement Agreement.

With regard to the unit price caps for storage inventory, storage injection, and storage withdrawal, the parties agree in Paragraph 16 of the Settlement Agreement that they will be set initially at the current levels set forth in SoCalGas' Schedule No. G-TBS, and are to be escalated in succeeding cost allocation proceedings in the following manner: the initial unit price caps are to be increased by the percentage increase (if any) in embedded inventory, injection, and withdrawal unit costs established by the Commission in each cost allocation proceeding during the term of the Settlement Agreement.

Paragraph 15 of the Settlement Agreement addresses the sharing mechanism for the revenues received by SoCalGas from the unbundled storage program. The net revenues (gross revenues minus embedded unit costs as

approved by the Commission) are to be shared between SoCalGas' ratepayers and shareholders as follows: the first \$15 million of net unbundled storage revenues are to be allocated on a 90/10 ratepayer/shareholder basis; the next \$15 million of net unbundled storage revenues are to be allocated on a 75/25 ratepayer/shareholder basis; and net unbundled storage revenues above \$30 million are to be allocated on a 50/50 ratepayer/shareholder basis. An annual cap of \$20 million will apply to the shareholder earnings. Paragraph 19 of the Settlement Agreement provides that the revenues obtained through the System Operator Hub, as approved in D.07-12-019, will be subject to this revenue sharing mechanism and are to be included in the \$20 million annual cap on shareholders' earnings.

In Paragraph 10 of the Settlement Agreement, the parties agree to meet in good faith to explore proposing an optional enhanced balancing service in Phase Two of this proceeding. This optional service would be available to noncore customers willing to pay for balancing tolerances greater than those provided in the tariff rules of SDG&E and SoCalGas. This optional service will not be proposed for the term of the Settlement Agreement unless the parties to the Settlement Agreement mutually agree.

Paragraph 11 of the Settlement Agreement provides that the proposal of SDG&E and SoCalGas in Phase Two to change the current 10% monthly balancing requirement to 5% will be withdrawn. In addition, for the term of the Settlement Agreement all of the imbalance tolerances that were in effect as of August 22, 2008 will be maintained. SDG&E and SoCalGas also agree not to institute a low Operational Flow Order (OFO) procedure during the term of the Settlement Agreement, and to withdraw their proposal for such a procedure from their testimony in Phase Two of this proceeding.

Paragraph 17 of the Settlement Agreement resolves the amounts recorded in the SoCalGas Noncore Storage Memorandum Account (NSMA). The settling parties agree that for 2008, the revenues booked to the NSMA will be offset by a negotiated storage cost of \$31.5 million. The net revenues (gross revenues minus \$31.5 million) are to be shared between ratepayers and shareholders using the revenue sharing mechanism described in Paragraph 15 of the Settlement Agreement. The ratepayers' share of the net revenues will be used to reduce customer transportation rates effective January 1, 2009, if the Settlement Agreement is approved in 2008. The NSMA is to be closed at the close of business on December 31, 2008.

Paragraph 20 of the Settlement Agreement provides that SoCalGas' SDG&E Storage Memorandum Account (SDGE SMA) will be closed with no adjustment to the transportation rates of the customers of SDG&E and SoCalGas.

### **3.3. Should the Proposed Settlement Agreement Be Adopted?**

In deciding whether the motion to adopt the Settlement Agreement should be granted or not, we are guided by Rule 12.1(d) of the Commission's Rules of Practice and Procedure. That subdivision states: "The Commission will not approve settlements, whether contested or uncontested, unless the settlement is reasonable in light of the whole record, consistent with law, and in the public interest." To determine whether the Settlement Agreement is reasonable in light of the whole record, and in the public interest, we compare the original positions of the parties to the recommended outcomes in the Settlement Agreement.

### **3.3.1. Combined Core Storage**

We first turn to the amount of storage that should be reserved for the core customers. The Settlement Agreement in Paragraph 5 initially allocates 79 Bcf of storage inventory capacity to the combined core customers of SDG&E and SoCalGas. This is the same amount that was recently established for the combined core customers of SDG&E and SoCalGas in D.07-12-019.

Pursuant to Paragraph 6 and Paragraph 7 of the Settlement Agreement, the storage inventory capacity is to be increased by 7 Bcf, of which 4 Bcf of this expanded capacity is to be added to the combined core's storage inventory capacity over four years.

SDG&E and SoCalGas proposed during the hearings that the combined core reliability could be met with 70 Bcf of storage inventory and 150 MMcfd of winter interstate pipeline capacity or border/citygate gas purchases. SCE supported the allocation proposal of SDG&E and SoCalGas.

DRA was of the view that the utilities' proposal appears to maximize the unbundled storage revenues for the benefit of their shareholders, instead of ensuring that their core customers have reliable and low cost gas supplies. DRA proposed that the combined core customers of SDG&E and SoCalGas be allocated 90 Bcf of storage inventory and provided testimony on the historical allocations of core storage to SDG&E and SoCalGas.

SCGC proposed that 78 Bcf of storage inventory be reserved for the core.

The Settlement Agreement's combined core storage inventory of 79 Bcf is a balanced and reasonable amount that is in the public interest. Although SDG&E, SoCalGas and SCE supported a lower amount during the hearings, the Settlement Agreement is consistent with the amount of storage that was set aside for the combined core in D.07-12-019 and the prior historical allocations to

SDG&E and SoCalGas. The 79 Bcf of storage also allows the combined core customers of SDG&E and SoCalGas to use storage to meet their winter needs instead of relying on the availability of interstate pipeline capacity during the winter and perhaps higher priced winter gas at the border or at the citygate.

Pursuant to the Settlement Agreement, the combined core customers of SDG&E and SoCalGas would be allocated 369 MMcfd of storage injection capacity, and 2225 MMcfd of storage withdrawal capacity. The amount of storage injection capacity would increase each year to match the growth in storage inventory capacity as described in Paragraph 6 and Paragraph 7 of the Settlement Agreement, up to a total of 388 MMcfd of storage injection capacity.

SDG&E and SoCalGas proposed during the hearings that their combined core customers be allocated 327 MMcfd of injection capacity, and 2225 MMcfd of withdrawal capacity. DRA proposed 420 MMcfd of injection capacity, in conjunction with its higher combined core storage inventory of 90 Bcf, and 2225 MMcfd of withdrawal capacity. SCGC proposed 350 MMcfd of storage injection and 2007 MMcfd of storage withdrawal, in conjunction with its recommended combined core storage allocation of 78 Bcf.

The Settlement Agreement's recommendation for the 369 MMcfd of injection capacity and 2225 MMcfd of withdrawal capacity is a reasonable amount that is in the public interest. These are the same amounts of injection capacity and withdrawal capacity that were recently approved by the Commission in D.07-12-019 in conjunction with the 79 Bcf of storage capacity. The 369 MMcfd of injection capacity and 2225 MMcfd of withdrawal capacity are also within the range that the various parties had proposed during the evidentiary hearings.

### **3.3.2. Wholesale Core Customers**

After combining SDG&E's core load with SoCalGas in D.07-12-019, there remain three wholesale core gas customers on the SoCalGas system. In addition to Southwest Gas and Long Beach, the other wholesale core gas customer on the SoCalGas system is the City of Vernon which has a very small core load.

With respect to the gas storage needs of the two large wholesale core customers, Southwest Gas and Long Beach, the Settlement Agreement provides that they are to be allocated storage capacity from the unbundled storage program at the same rates in the Settlement Agreement for the combined core customers of SDG&E and SoCalGas. The rates may be revised in future cost allocation proceedings to reflect new embedded costs.

Paragraph 13 of the Settlement Agreement provides that upon the approval of the Settlement Agreement by the Commission, Southwest Gas is to be allocated 1.98% of the inventory, injection, and withdrawal capacities that are allocated to the combined core customers of SDG&E and SoCalGas in the Settlement Agreement. This percentage allocation will result in approximately 1.56 Bcf of storage inventory, 7.31 MMcfd of storage injection, and 44.06 MMcfd of storage withdrawal for Southwest Gas. The Settlement Agreement also provides that if Southwest Gas' core load or a portion of its core load is directly served under an agreement between PG&E and Southwest Gas during the term of the settlement, that Southwest Gas' percentage of storage set-asides will be adjusted no earlier than April 1 of the subsequent year to reflect the ratio of Southwest Gas' core load served by SoCalGas and the capacities allocated to the combined core customers of SDG&E and SoCalGas. During the term of the Settlement Agreement, Southwest Gas has the option to reduce its commitment in each future cost allocation proceeding.

Paragraph 14 of the Settlement Agreement provides that upon the approval of the Settlement Agreement by the Commission, Long Beach is to be allocated storage inventory capacity of 0.635 Bcf, injection capacity of 2.9 MMcfd, and withdrawal capacity of 31.6 MMcfd. On April 1, 2012, Long Beach may increase its allocated storage inventory to 0.7 Bcf, 3.3 MMcfd of injection capacity, and 36 MMcfd of withdrawal capacity. The Settlement Agreement also provides that in each future cost allocation proceeding during the term of the Settlement Agreement, Long Beach may reduce its allocated storage capacities.

During the hearings, Southwest Gas and Long Beach argued that “core parity” should apply to both of them as wholesale core customers. Core parity is the concept that the wholesale core customers should be treated the same as the core customers of SDG&E and SoCalGas. (See D.07-12-019, § 9, pp. 93-99.) As part of their core parity arguments, Southwest Gas and Long Beach argued that they should receive the same level of service, and that their rates should be the same, as what the combined core customers of SDG&E and SoCalGas receive.

Southwest Gas and Long Beach opposed the proportional allocation formula that SDG&E and SoCalGas planned to use to allocate the storage assets to the wholesale core customers. Southwest Gas favored using a modified version of SoCalGas’ allocation formula to reflect the actual customer demands of Southwest Gas. Long Beach argued that its own storage forecast should be used, and that it should receive 0.650 Bcf of firm inventory capacity, 3.0 MMcfd of firm injection capacity, and 32.445 MMcfd of firm withdrawal capacity.

In D.07-12-019, the Commission deferred to this proceeding the issue of core parity pricing for wholesale core customers. D.07-12-019 also established

memorandum accounts to track the cost of storage charged to Southwest Gas and Long Beach to the extent such charges exceed what SoCalGas' core customers paid. At the evidentiary hearings, SDG&E and SoCalGas were neutral on the issue of whether the Commission should provide the storage assets to wholesale core customers at the same rates that the combined core customers of SDG&E and SoCalGas pay. However, SDG&E and SoCalGas were against any gaming that would allow wholesale core customers to switch to the G-TBS tariff if the storage market prices were to fall below the combined core storage costs during the cost allocation period.

SCE opposed the core parity pricing request. Instead, SCE argued that the wholesale core customers should pay for storage at market-based rates. SCE also opposed the core parity argument that the volume of storage assets allocated to the wholesale core customers should be increased. SCE argued that wholesale core customers should be allocated only the storage capacity that they need to meet the reliability needs of their customers, and allocating more than that will reduce the amount of storage assets available to the noncore customers.

DRA recommended that the wholesale gas customers should have the opportunity to contract for the same proportional mix of storage assets as the combined core customers of SoCalGas and SDG&E, and that the total wholesale core gas storage set-asides should equal 3.4% of the combined core of SDG&E and SoCalGas. DRA also recommended that the wholesale core customers pay the same prices for storage services as those paid by the combined core customers of SDG&E and SoCalGas, and that the wholesale core customers enter into long term contracts, i.e., for a period of at least 10 years.

Under the Settlement Agreement, the storage capacities allocated to the wholesale core customers of Southwest Gas and Long Beach are lower than the previous amount of storage capacities that they held. During the period from 2003-2007, the wholesale core customers held an average of 2.32 Bcf of storage inventory capacity, 16.9 MMcfd of injection capacity and 98.1 MMcfd of withdrawal capacity. Under the Settlement Agreement, the storage inventory of Southwest Gas and Long Beach would be approximately 2.2 Bcf at the outset; the injection capacity would be approximately 10.21 MMcfd; and the withdrawal capacity would be approximately 75.7 MMcfd. Based on the history of the wholesale core storage assets and the litigation positions of the parties, the Settlement Agreement provisions for the storage capacities for Southwest Gas and Long Beach and the pricing of those services are reasonable in light of the record and in the public interest. SoCalGas should close the Long Beach Storage Memorandum Account (LB SMA) and the Southwest Gas Storage Memorandum Account (SG SMA) without any adjustment.

### **3.3.3. Total Storage Capacity and the Unbundled Storage Program**

SoCalGas agrees in Paragraph 4 of the Settlement Agreement to use reasonable efforts to maintain a total of 131.1 Bcf of storage inventory capacity, 850 MMcfd of storage injection capacity, and 3195 MMcfd of storage withdrawal capacity. In Paragraph 12 of the Settlement Agreement, the amount of storage inventory, injection, and withdrawal capacity that will be made available to the unbundled storage program and to wholesale core customers shall be the amount remaining after the allocation to the combined core customers of SDG&E and SoCalGas and to the balancing function.

In Paragraph 6 and Paragraph 7 of the Settlement Agreement, SoCalGas agrees to make reasonable efforts to expand its storage inventory at its four existing gas storage fields by 7 Bcf over the period 2009-2014, of which 3 Bcf of the inventory capacity is to be allocated to the unbundled storage program and 4 Bcf to the combined core customers of SDG&E and SoCalGas. The parties to the Settlement Agreement agree to support the expeditious approval of any CPCN application that SoCalGas may file to construct the expanded storage inventory.

The Settlement Agreement in Paragraph 8 provides for the expansion of the overall injection capacity by approximately 145 MMcfd at Aliso Canyon. This expansion would occur as a result of the replacement of the existing turbines that are used to compress the gas for injection into storage and through storage injection expansion projects. The parties to the Settlement Agreement agree to support the expeditious approval of any CPCN application to construct these storage injection facilities.

One of the issues identified in the scoping memo was whether SoCalGas has an obligation to maximize the availability of storage for the unbundled storage program and the hub services program. The Settlement Agreement addresses this issue. By allocating a certain amount of the storage assets to the combined core customers of SDG&E and SoCalGas, to the wholesale core customers, and to balancing, that will allow SoCalGas to maintain and make available certain levels of storage inventory capacity, injection capacity, and withdrawal capacity in the unbundled storage program. After these allocations are made, as provided for in the Settlement Agreement, there will be approximately 45.71 Bcf of inventory capacity, 270.8 MMcfd of injection capacity, and 554.4 MMcfd of withdrawal capacity available to the unbundled

storage program. In addition, the unbundled storage inventory capacity will increase by 3 Bcf as a result of the agreement that the storage inventory capacity be expanded by an additional 7 Bcf.

During the evidentiary hearings, SDG&E and SoCalGas took the position that they had no obligation to maximize the amount of storage assets for the unbundled storage program. To encourage the utilities to maximize the amount of storage to the unbundled storage program, SDG&E and SoCalGas advocated that the 50/50 sharing mechanism for existing storage assets, and the 100% risk/reward for new storage expansions, be adopted.

Shell Energy argued that SoCalGas should have an affirmative obligation to maximize the amount of storage that it makes available through the unbundled storage program.

SCGC took the position that SoCalGas is obligated under the unbundled storage decision, D.93-02-013, to offer firm unbundled storage service from existing facilities to noncore customers after the core reservations have been made. SCGC also recommended that SoCalGas be ordered to modify the preliminary statement in its tariffs to include a statement that it has the obligation to provide firm storage services up to the full capacity of its existing unbundled storage facilities.

SCE took the position that at least 51 Bcf of storage inventory should be made available for the unbundled storage program.

When one compares the Settlement Agreement provisions about the amount of storage assets that are to be made available to the unbundled storage program, to the positions that the parties advocated during the hearings and to other relevant provisions in the Settlement Agreement, the provisions represent a negotiated compromise of the parties' positions on the amount of unbundled

storage that should be made available. The Settlement Agreement balances the interrelationship between expanding storage for the unbundled storage program, while providing incentives for the utilities to do so (as discussed in Section 3.3.4.). We find that the provisions in the Settlement Agreement pertaining to the total amount of storage assets and how much of that should be allocated to the unbundled storage program are reasonable and in the public interest.

### **3.3.4. Treatment of Unbundled Storage Revenues and Hub Revenues**

In D.07-12-019, the issue of whether the unbundled storage revenues and hub service revenues should be shared between ratepayers and shareholders was deferred to this proceeding. The related issue of whether a cap should apply to the shareholders' portion of any net revenues was also deferred to this proceeding.

The Settlement Agreement resolves those issues in Paragraph 15 and Paragraph 19. In Paragraph 15, the parties agree that the net revenues<sup>4</sup> from the unbundled storage program are to be shared between ratepayers and shareholders in accordance with the following schedule. The first \$15 million of the net unbundled storage revenues is to be allocated 90% to ratepayers and 10% to shareholders. The next \$15 million in net revenues is to be allocated 75% to ratepayers and 25% to shareholders. The net revenues above \$30 million are to be allocated to ratepayers and shareholders on a 50/50 basis. The

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<sup>4</sup> Paragraph 15 of the Settlement Agreement provides that for the purpose of calculating the net revenues, the costs are to be based on the embedded unit costs that will be decided in Phase 2 of this proceeding, and as revised in each cost allocation proceeding during the term of the Settlement Agreement.

shareholders' earnings from their share of the net revenues is to be capped at \$20 million per year.

In Paragraph 19 of the Settlement Agreement, the parties agree that the net revenues from the System Operator Hub will be treated as unbundled storage revenues. The net revenues will be subject to the sharing mechanism described above, including the \$20 million annual cap on the shareholders' earnings.

SDG&E and SoCalGas took the position at the Phase One evidentiary hearings that the unbundled storage revenues and the revenues from hub services, using the existing storage assets, should continue to be shared between the ratepayers and shareholders on a 50/50 basis, and that a revenue cap of \$20 million should apply to the shareholders' portion of the net revenues. The 50/50 revenue sharing mechanism between ratepayers and shareholder was originally put into place by D.00-04-060.

SCE supported the proposal of SDG&E and SoCalGas so long as the core storage inventory is reduced to 70 Bcf and the quantity of storage capacity available to the unbundled storage program is increased to 51 Bcf. If the amount of unbundled storage capacity falls below the 51 Bcf, SCE proposed that a sliding revenue cap be applied to the shareholders' incentive.

DRA recommended that net storage revenues be shared between ratepayers and shareholders on a 90/10 split for the first \$15 million, on a 75/25 split for the second \$15 million, and on a 50/50 split for any revenues above \$30 million. DRA's proposal would also limit the shareholders' annual share with a cap at \$15 million. DRA also pointed out that the 50/50 incentive mechanism that the utilities propose be retained, was put into place by the

Commission when the market conditions for storage were quite different from what exists today.

SCGC recommended at the evidentiary hearings that an 85/15 sharing of net revenues from the existing unbundled storage assets be adopted for ratepayers and shareholders. SCGC took the position that its sharing proposal would reasonably assure that SoCalGas will earn sufficient net revenues to meet its incremental costs.

Shell Energy argued that because SoCalGas has market power over gas storage in southern California, and because SoCalGas earns a generous rate of return on its fixed assets, there is no need for an incentive mechanism to reward shareholders for the sale of unbundled storage. Shell Energy recommended that any revenues from the sale of unbundled storage and from hub services, in excess of SoCalGas' actual costs, should be returned to SoCalGas' ratepayers.

The recommendations in Paragraphs 15 and 19 of the Settlement Agreement as to how the net revenues from the unbundled storage program and hub services should be treated represent a balanced compromise of a contentious and significant issue in this phase of the proceeding. Instead of the 50/50 sharing proposal of SoCalGas and SDG&E, all of the parties to the Settlement Agreement agreed to a sharing proposal that provides substantial benefits to ratepayers from the first \$30 million in unbundled storage revenues, while providing a significant monetary incentive (\$20 million cap) for SoCalGas to maximize the sales of storage-related services while minimizing costs. In addition, the Settlement Agreement provisions regarding how the unbundled storage revenues and hub revenues will be treated provide the incentives for SDG&E and SoCalGas to expand the amount of unbundled storage. These provisions also provide certainty over the term of the settlement as to how the net revenues from these services will be treated and how future storage expansions will be treated as discussed in Section 3.3.7. With gross unbundled storage revenues of \$72 million in 2006 and \$79 million in 2007, the provisions in the Settlement Agreement regarding how the net revenues from the unbundled storage program and from hub services will be shared are reasonable and in the public interest.

### **3.3.5. Balancing**

The scoping memo had planned to address the balancing issues in Phase Two of this proceeding. However, the settling parties agreed to resolve certain balancing issues in Paragraphs 9, 10, and 11 of the Settlement Agreement.

In Paragraph 9 of the Settlement Agreement, the parties agreed to allocate 4.2 Bcf of storage inventory capacity, 200 MMcfd of injection capacity, and 340 MMcfd of withdrawal capacity to the balancing function. The parties

also agreed as to how the revenue requirement for these allocated capacities will be derived, and that the combined core customers of SDG&E and SoCalGas shall only be allocated a share of the balancing costs for the storage injection and withdrawal capacities.

The parties agreed in Paragraph 10 of the Settlement Agreement to discuss whether an optional enhanced balancing service could be offered. The idea behind this service is to allow noncore customers to pay for greater balancing tolerances than are provided for in the tariffs. Such a service will not be proposed for the term of the Settlement Agreement unless the settling parties mutually agree.

In Paragraph 11 of the Settlement Agreement, SDG&E and SoCalGas agreed to withdraw their proposal in Phase Two of this proceeding to reduce the current 10% monthly balancing requirement to 5%. The utilities agreed to maintain, for the term of the Settlement Agreement, all imbalance tolerances in effect as of August 22, 2008, including the 10% monthly tolerance and current daily imbalance tolerances that are applicable to nominations in excess of system capacity and imbalances during the winter operating periods. The utilities also agreed not to institute a low OFO procedure during the term of the settlement, and to withdraw their proposal in Phase Two of this proceeding for such a procedure.

In its Phase Two testimony, SDG&E and SoCalGas recommended reducing the monthly balancing tolerance from 10% to 5%. They also proposed to impose a low OFO condition (i.e., customer's supply must be greater than 90% of the customer's burn) anytime during the winter when the system operator forecasts 80% or more of the withdrawal capacity being used. In

addition, they proposed imposing low or high OFOs based on the balancing inventory levels.

SCE expressed concern that SoCalGas' proposed reduction in the monthly balancing tolerance would create significant balancing problems for SCE and other shippers on the SoCalGas system. SCE also expressed concern that the more restrictive balancing requirement could lead to an increased demand for storage assets, which would result in higher electricity costs to end-users.

The three paragraphs in the Settlement Agreement that address the balancing issues resolve the amount of storage assets that are to be allocated to the balancing function, retain the current balancing tolerances, and opens a discussion on whether customers want an enhanced balancing service. When these balancing issues are compared to the parties' positions on how much storage should be made available to the unbundled storage program, the balancing proposals that SDG&E and SoCalGas had planned to advance in Phase Two of this proceeding, and the operational impacts on customers, these provisions are reasonable and in the public interest.

### **3.3.6. Prices for Storage Services**

In Paragraph 16 of the Settlement Agreement, the parties agree that the individual unit price caps for storage inventory, storage injection, and storage withdrawal will be set initially at the levels that are currently set forth in SoCalGas' Schedule No. G-TBS. Those rate caps will be escalated by the percentage increase, if any, in the embedded inventory, injection, and withdrawal unit costs to be established by the Commission in each cost allocation proceeding over the term of the Settlement Agreement.

One of the issues in Phase Two of this proceeding was whether an embedded cost or long run marginal cost (LRMC) methodology should be used to determine the cost of the storage service. SDG&E and SoCalGas favored the use of the embedded cost methodology, while some of the other parties believed that a LRMC methodology should be used. Paragraph 16 of the Settlement Agreement, as well as other paragraphs of the Settlement Agreement, refers to the use of embedded costs that will be determined in the cost allocation proceedings.

The agreement in Paragraph 16 of the Settlement Agreement establishes the initial price cap for the unbundled storage services, as well as subsequent increases to the price cap. By agreeing to do so, the settling parties have resolved the maximum prices that can be charged under the G-TBS rate schedule and the cost methodology to be used during the term of the Settlement Agreement. When these price and methodology issues are considered along with the other provisions in the Settlement Agreement and the parties' litigation positions, Paragraph 16 is reasonable and in the public interest.

### **3.3.7. Future Storage Expansions**

The Settlement Agreement in Paragraph 18 addresses future gas storage expansion projects that might be undertaken during the term of the Settlement Agreement. The future expansions are in addition to the expansions described in Paragraphs 6 and 8 of the Settlement Agreement. The future expansions contemplated in Paragraph 18 will be deemed to be undertaken for the unbundled storage program, and the revenues obtained from such expansions will be included in the revenue sharing mechanism described in Paragraph 15 of the Settlement Agreement.

Paragraph 18 also provides that once the expansion facilities are used and useful in providing storage service, the cost of the storage expansions will be added to SoCalGas' storage rate base through a general rate case or application requesting Commission authority to construct the expansion facilities. The associated increase in the revenue requirement will be reflected in the cost of the unbundled storage program used for the purpose of calculating net revenues for revenue sharing purposes in the next cost allocation proceeding. The increase in storage capacities created by the expansions will be allocated to the unbundled storage program in the next cost allocation proceeding.

The future expansion of storage assets is related to the issue of how much storage should be made available to the unbundled storage program, and to the revenue sharing issue from the additional storage capacities that will be created from the expansions. D.07-12-019 deferred to this proceeding the issue of what risk sharing mechanism should be adopted for storage expansions.

SDG&E and SoCalGas proposed during the evidentiary hearings that they be 100% at risk for any future storage expansion projects and that they receive 100% of the revenues from such expansions. SDG&E and SoCalGas argued that allowing them to bear all the risk and reward would provide them with an incentive to undertake new storage expansion projects, and that this type of risk/reward treatment was already in place for new storage in northern California.

SCE supported the proposal of SDG&E and SoCalGas for a 100% risk/reward mechanism for future storage projects.

DRA also supported the 100% risk/reward structure so long as the combined core customers of SDG&E and SoCalGas are allocated the capacity

amounts that DRA had proposed, that the expansion be limited to the four existing gas storage fields of SoCalGas, and that the expansions not exceed 25 Bcf of storage inventory and 200 MMcfd of storage injection.

SCGC recommended that the storage expansions be rate based and the resulting costs should be added to its proposal for an 85/15 sharing mechanism.

Shell Energy took the position that the expanded storage should be priced on a cost-of-service basis. Shell Energy proposed that SoCalGas should be required to make a determination on whether the cost of the expanded storage capacity should be rolled-in to SoCalGas' unbundled storage revenue requirement, or whether the cost of the expanded storage should be paid for by the subscribing customer or shipper on an incremental cost basis.

Paragraph 18 of the Settlement Agreement represents a balance of encouraging additional storage to be built for the unbundled storage program, providing incentives so that the utilities will build the storage expansions, and keeping gas storage rates at reasonable levels. When this provision is viewed as part of the overall Settlement Agreement, Paragraph 18 is reasonable and in the public interest.

### **3.3.8. Storage Accounts**

The Settlement Agreement addresses two gas storage accounts. Paragraph 17 of the Settlement Agreement addresses SoCalGas' NSMA (Noncore Storage Memorandum Account), and Paragraph 20 of the Settlement Agreement addresses SoCalGas' SDGE SMA.

#### **3.3.8.1. NSMA**

In D.07-12-019, we directed that the NSMA record the noncore storage costs and revenues. D.07-12-019 also directed that the BCAP address the

revenue sharing proposals, and that the revenues recorded in this memorandum account be allocated based on the sharing mechanism adopted by the Commission in the BCAP.

In Paragraph 17 of the Settlement Agreement, the parties agree that the revenues that were booked to the NSMA be offset by the agreed upon storage cost of \$31.5 million, and that the net revenues be shared between ratepayers and shareholders in accordance with the sharing mechanism described in Paragraph 15 of the Settlement Agreement. Paragraph 17 also describes how the reduction in customer transportation rates resulting from the allocation to ratepayers of their estimated share of net NSMA revenues will be incorporated into other transportation rate adjustments for SDG&E and SoCalGas, effective January 1, 2009. In addition, the Settlement Agreement provides that the NSMA is to be closed as of the close of business on December 31, 2008.

SoCalGas' litigation position on the NSMA was that the ratepayers and shareholders should share the amounts in the NSMA on a 50/50 basis, and that \$21 million in storage costs should be used to offset the gross revenues.<sup>5</sup>

DRA recommended that the amounts in the NSMA should be disposed of using DRA's graduated sharing mechanism. SCGC recommended that \$36 million in costs should be used to offset the gross revenues in the NSMA, instead of the \$21 million in embedded costs that SDG&E and SoCalGas had recommended.

In Section 3.3.4. of this decision, we addressed the Settlement Agreement's treatment of the revenues from the unbundled storage program. Paragraph 17 of the Settlement Agreement recommends that the net revenues

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<sup>5</sup> SDG&E and SoCalGas also asserted that the updated total embedded cost of the unbundled storage is \$27 million.

in the NSMA be allocated in accordance with how the Settlement Agreement resolves the treatment of the unbundled storage revenues. For the reasons stated in Section 3.3.4., the agreed upon treatment of the balance in the NSMA is a reasonable approach that is in the public interest.

### **3.3.8.2. SDGE SMA**

The purpose of the SDGE SMA was to record the difference between the gas storage rates that SDG&E's core customers pay SoCalGas, and the cost-based rate that SoCalGas' core customers pay. The SDGE SMA was established on March 17, 2005 in Resolution G-3378. We stated in the resolution that this memorandum account would be reviewed in this proceeding. Subsequently, on April 1, 2008, and as a result of D.07-12-019, the core portfolio of SDG&E was combined with SoCalGas' core portfolio, which eliminated the need for further entries to the SDGE SMA. According to SDG&E and SoCalGas, there is a credit of approximately \$13.401 million in the SDGE SMA.

In Paragraph 20 of the Settlement Agreement, the settling parties agreed to close the SDGE SMA without the need to adjust the transportation rates of the core customers of SDG&E or SoCalGas.

At the evidentiary hearings, SDG&E and SoCalGas recommended that the SDGE SMA be closed and that nothing be done with the recorded amounts. The utilities' witness provided an explanation in Exhibit 4 as to why the SDGE SMA should be closed without any adjustments.

SCGC took the position that if SoCalGas actually booked incremental revenues to the SDGE SMA rather than tracking the difference, then the dollars booked into the SDGE SMA should flow to the NSMA for disposition by the Commission. However, if the SDGE SMA is a tracking mechanism and all dollars associated with SDG&E's storage contract have already been booked to

the NSMA during 2006 and 2007, then SCGC agrees that the SDGE SMA should be closed and the balance disregarded.

DRA opposed the utilities' position during the evidentiary hearings, and recommended that consistent with the intent of Resolution G-3778, the \$13.401 million in the SDGE SMA should be returned to SDG&E's ratepayers.

The Settlement Agreement's recommendation to close the SDGE SMA without any adjustment is a reasonable outcome that is in the public interest in light of the other provisions agreed to in the Settlement Agreement, as well as the evidence that was presented regarding the SDGE SMA.

### **3.4. Conclusion**

Although some of the settling parties may disagree with specific parts of the Settlement Agreement, when all of the various provisions in the Settlement Agreement are considered as part of the whole, it makes for a balanced approach for resolving the Phase One issues and the balancing issues. The Settlement Agreement's balancing of the various interests of the different parties will ensure that core and noncore customers in southern California will have sufficient storage services during the term of the Settlement Agreement, while providing monetary incentives to SDG&E and SoCalGas to encourage them to expand the storage assets for the unbundled storage program.

For all of the reasons discussed earlier, the Settlement Agreement is reasonable and in the public interest. Since no one raised any legal objections to the motion to adopt the Settlement Agreement or to the provisions in the Settlement Agreement, we also conclude that the Settlement Agreement is consistent with the law. Accordingly, the motion to adopt the Settlement Agreement should be granted, and the terms of the Settlement Agreement, which is attached to this decision as Attachment 1, should be adopted.

The net revenues in the NSMA shall be shared between ratepayers and shareholders as provided for in Paragraphs 15 and 17 of the Settlement Agreement, and SDG&E and SoCalGas shall take the necessary steps to consolidate the ratepayers' share of these net revenues with the other SDG&E and SoCalGas transportation rate adjustments to be effective January 1, 2009. The SDGE SMA shall be closed without any adjustment.

SDG&E and SoCalGas shall take the necessary steps to incorporate the other provisions in the Settlement Agreement into their gas system and storage operations as each situation contemplated by the Settlement Agreement arise.

SDG&E and SoCalGas shall be directed to file the necessary advice letters to carry out the terms of the Settlement Agreement.

This proceeding remains open to address the remaining issues in Phase Two of this proceeding.

#### **4. Comments on Proposed Decision**

The proposed decision of Administrative Law Judge (ALJ) John S. Wong in this matter was mailed to the parties in accordance with § 311 of the Public Utilities Code. Opening comments were filed by SDG&E and SoCalGas and Long Beach. These comments have been incorporated into the decision.

#### **5. Assignment of Proceeding**

Timothy Alan Simon is the assigned Commissioner and John S. Wong is the assigned ALJ in this proceeding.

### **Findings of Fact**

1. Following the evidentiary hearings in Phase One, the parties met to discuss the possible settlement of the Phase One issues.

2. On August 22, 2008, SDG&E, SoCalGas, and nine other parties filed the motion to adopt the Settlement Agreement.

3. The briefing schedule for the filing of opening and reply briefs in Phase One was suspended due to the request to suspend the briefing schedule in the motion to adopt the Settlement Agreement.

4. No comments on the motion to adopt the Settlement Agreement were filed.

5. The Settlement Agreement contains the recommendations of the settling parties regarding the Phase One issues, as well as some of the gas balancing issues in Phase Two.

6. The Settlement Agreement addresses the total amount of gas storage capacities that will be made available during the term of the settlement, the allocations to the combined core customers of SDG&E and SoCalGas, the allocations to the wholesale core customers, and the allocations to the balancing function.

7. The Settlement Agreement also addresses the future expansion of the gas storage assets, and the sharing mechanism that ratepayers and shareholders will use to allocate the net revenues from the unbundled storage program and hub services.

8. The Settlement Agreement also resolves the NSMA and SDGE SMA accounts.

9. When all of the various provisions in the Settlement Agreement are considered as part of the whole, it makes for a balanced approach for resolving the Phase One issues and the balancing issues.

10. The Settlement Agreement will ensure that the core and noncore customers in southern California will have sufficient storage services during the term of the settlement, while providing monetary incentives to SDG&E and SoCalGas to encourage them to expand the storage assets for the unbundled storage program.

11. No one raised any legal objections to the motion to adopt the Settlement Agreement or to the provisions in the Settlement Agreement.

### **Conclusions of Law**

1. For all of the reasons discussed in this decision, the Settlement Agreement is reasonable in light of the whole record and in the public interest.

2. The Settlement Agreement is consistent with the law.

3. The motion to adopt the Settlement Agreement should be granted, and the terms of the Settlement Agreement should be adopted.

4. SDG&E and SoCalGas should take the necessary steps to allocate the net revenues in the NSMA, as provided for in Paragraph 15 and Paragraph 17 of the Settlement Agreement, and to consolidate the ratepayers' share of the net revenues with the other SDG&E and SoCalGas transportation rate adjustments to be effective January 1, 2009.

5. SoCalGas should close the SDGE SMA, the LB SMA and the SG SMA without any adjustment.

6. SDG&E and SoCalGas should take the necessary steps to incorporate the other provisions in the Settlement Agreement into their gas system and storage operations as each situation contemplated by the Settlement Agreement arises.

7. SDG&E and SoCalGas should be directed to file the necessary advice letters under Tier 2 of General Order 96-B to carry out the terms of the Settlement Agreement.

## **ORDER**

**IT IS ORDERED** that:

1. The August 22, 2008 joint motion “For Adoption of Settlement Agreement and Immediate Suspension of Briefing Schedule for Phase One Issues” is granted, and the terms of the Settlement Agreement, which is attached to this decision as Attachment 1, are adopted.

2. San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) shall take the necessary steps to allocate the net revenues in the Noncore Storage Memorandum Account, as provided for in Paragraph 15 and Paragraph 17 of the Settlement Agreement, and to consolidate the ratepayers’ share of the net revenues with the other SDG&E and SoCalGas transportation rate adjustments to be effective January 1, 2009.

3. SoCalGas shall close the SDGE Storage Memorandum Account, the LB Storage Memorandum Account, and the SG Storage Memorandum Account without any adjustment.

4. SDG&E and SoCalGas shall take the necessary steps to incorporate the other provisions in the Settlement Agreement into their gas system and storage operations as each situation contemplated by the Settlement Agreement arises.

5. SDG&E and SoCalGas shall file the necessary advice letters with the Energy Division under Tier 2 of General Order 96-B to carry out the terms of the Settlement Agreement. Any interested party may protest the advice letter filings as provided for in General Order 96-B. For the advice letter seeking to

revise transportation rates effective January 1, 2009, SDG&E and SoCalGas shall file that advice letter within five days of today's date, and the protest period for this particular advice letter shall be shortened to 15 days. No additional customer notice is needed for these advice letter filings as provided for in section 4.2 of General Order 96-B.

6. Pursuant to Pub. Util. Code § 1701.5 and for purposes of reviewing the issues delineated in the Scoping Memo of April 17, 2008, Phase 1 is closed.

7. This proceeding remains open to consider the remaining issues in Phase Two.

This order is effective today.

Dated December 4, 2008, at San Francisco, California.

MICHAEL R. PEEVEY  
President  
DIAN M. GRUENEICH  
JOHN A. BOHN  
RACHELLE B. CHONG  
TIMOTHY ALAN SIMON  
Commissioners