

PUBLIC UTILITIES COMMISSION505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

June 25, 2003

Agenda ID #2425
Ratesetting

TO: PARTIES OF RECORD IN APPLICATION 02-10-040

This is the draft decision of Administrative Law Judge (ALJ) Halligan. It will not appear on the Commission's agenda for at least ten (10) days after the date it is mailed. The Commission may act then, or it may postpone action until later.

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

Pursuant to Rule 77.7(f)(9), comments on the draft decision must be filed within ten (10) days of its mailing and no reply comments will be accepted.

In addition to service by mail, parties should send comments in electronic form to those appearances and the state service list that provided an electronic mail address to the Commission, including ALJ Halligan at JMh@cpuc.ca.gov. Finally, comments must be served separately on the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious methods of service.

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

ANG:hl2

Attachment

Decision **DRAFT DECISION OF ALJ HALLIGAN** (Mailed 6/25/2003)**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of San Diego Gas and Electric Company (U 902 G) to Modify and Extend Permanent Gas Procurement Performance-Based Ratemaking Mechanism.

Application 02-10-040
(Filed October 31, 2002)

OPINION APPROVING SETTLEMENT AGREEMENT**I. Summary**

This order approves a settlement between San Diego Gas & Electric Company (SDG&E) and the Office of Ratepayer Advocates (ORA). Under the settlement, SDG&E's existing Gas Performance-Based Ratemaking (PBR) mechanism will continue with certain agreed-upon modifications that will apply to PBR Year 10 (August 1, 2002 through July 31, 2003) and beyond, as follows:

1. Modification of the benchmark for non-Southwest basin purchases to provide for comparison of Canadian gas purchases with an Alberta, Canada basin index in a manner exactly analogous to the treatment of San Juan or Permian basin purchases.
2. Institution of an annual PBR reward cap of 1.5% of total annual benchmark costs including transportation to the Southern California Gas company (SoCalGas) intrastate system.
3. Revision of the sharing formula so that savings (rewards) and above-deadband costs (penalties) are uniformly shared 50-50 between customers and shareholders.

With the adoption of the settlement, this proceeding is closed.

II. Categorization and Need for Hearings

In Resolution ALJ 176-3099, dated November 7, 2002, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were necessary. No hearings were held. Given this development, it is necessary to change the preliminary determination that hearings were required.

III. Background and Procedural Summary

SDG&E's Gas PBR mechanism was first approved by the Commission in Decision (D.) 93-062-092, as an alternative to traditional reasonableness reviews. The Gas PBR mechanism's initial experimental two-year term began on August 1, 1993. The Commission then extended and modified the experimental mechanism for two-year terms by Resolution G-3187, D.95-04-51 and D.97-02-012 and other Commission actions. Although initially established as an experimental program, the Commission, in D.98-08-038, adopted the Gas PBR mechanism for a five-year term, extending for Years Five through Ten.

D.98-08-038 ordered SDG&E, "to file an application to extend the term of, modify or discontinue the Gas Procurement PBR Mechanism approved herein no later than the fourth year of the term (July 31, 2002)." At the end of the fourth year, SDG&E and SoCalGas were awaiting Commission action on their request to consolidate their gas portfolios in Application (A.)01-01-021 which, if approved, would have eliminated SDG&E's Gas PBR mechanism. SDG&E, therefore, requested and the Commission granted an extension to file the application on October 31, 2002. Subsequently, D.02-08-065 was issued, deferring any decision on the application for gas portfolio consolidation pending

Commission action in the California 2000/2001 border price spikes Investigation (I.) 02-11-040.

On October 31, 2002, SDG&E filed A.02-10-040 seeking authority to continue SDG&E's permanent Gas PBR mechanism from August 1, 2003 (Year 11) until approval of an application to modify or discontinue the Gas PBR mechanism or Commission approval of the consolidation of the SDG&E and SoCalGas gas portfolios. The Application requested continuation of SDG&E's existing Gas PBR mechanism in light of the measurable benefits it has provided to customers and the mechanism's simplification of regulation. The Application also proposed three improvements to the existing mechanism, discussed below.

On December 5, 2002, ORA filed a protest to the Application stating that it planned to review, evaluate and respond to SDG&E's proposals. This protest was the only such filing in response to SDG&E's application.

At a prehearing conference on February 6, 2003, SDG&E and ORA informed the Commission that they planned to pursue settlement negotiations and would strive to submit a settlement agreement for approval by April 30, 2003. Although other parties attended the prehearing conference and made "information only" appearances, these parties did not indicate an intent to participate in settlement discussions. Therefore, only ORA and SDG&E (Settling Parties), the active parties in the proceeding, participated in the negotiations culminating in a settlement.

Pursuant to Rule 51.1(b), SDG&E gave notice of a settlement conference and that conference was held on February 20, 2003. Settlement negotiations continued from that conference through the end of April 2003. The initial phase of negotiations involved discovery by ORA in regard to the proposed modifications of the Gas PBR mechanism, which was followed by a series of

conferences. On April 30, 2003, the Settling Parties informed the Commission that they had reached a settlement and requested an extension of time to file and serve a settlement agreement, no later than May 9, 2003. On May 1, 2003, Administrative Law Judge Halligan granted the request. On May 9, 2003, the Settling Parties filed a joint motion entitled “Joint Motion of San Diego Gas & Electric Company and the Office of Ratepayer Advocates for Order Adopting Settlement Agreement.” (Joint Motion.)

IV. The Settlement

The settlement provides for the continuation of the existing Gas PBR mechanism and sets forth the structure of the modifications to the mechanism that shall apply for PBR Year 10 (August 1, 2002 through July 31, 2003) and beyond. The existing sharing formula provides for 50/50 sharing of savings between customers and shareholders and that costs more than 2% above the benchmark are shared 75% to shareholders and 25% to customers. There is no shareholder reward cap under the current PBR mechanism. The settlement modifies the sharing formula for savings through (1) a 100% allocation of savings to customers up to 1% below the benchmark;¹ (2) 75/25 sharing of savings (75% of savings to ratepayers, 25% of savings to shareholders) more than 1% below the benchmark; and (3) an annual Gas PBR shareholder award cap of the lower of 1.5% of the total commodity benchmark costs or \$6 Million. The settlement also provides for a modification in the sharing of losses with a 50/50 sharing of losses above the 2% deadband. The current Gas PBR mechanism and the proposed changes are shown on Appendix A, attached to this decision.

¹ This sharing band is actually a tolerance band, under which no sharing occurs.

In addition, the settlement modifies the benchmark for non-Southwest basin gas purchases to allow consistent treatment of non-Southwest basin purchases and Southwest basin purchases. The existing mechanism utilizes a Southern California border gas cost benchmark for evaluating all gas purchases made at locations other than the San Juan and Permian basins. The settlement provides that the benchmark for non-Southwest basin gas purchases will compare Canadian gas purchases with an Alberta, Canada basin index in the same manner than San Juan and Permian basin gas purchases are treated under the existing Gas PBR mechanism. As with Southwest purchases, this modification would allow the success of Canadian gas purchases to be measured by the ability to acquire gas at below basin indices and not be affected by the vagaries of transportation basis differentials.

The Settling Parties believe that the structure of the modifications to the Gas PBR mechanism reflected in the settlement represents a compromise between the positions of the Settling Parties, and a reasonable balance of competing interests. The Settling Parties also believe that the continuation of the other components of the Gas PBR mechanism will benefit SDG&E's customers, simplify regulation and reduce administrative burden through a collaborative process.

V. Discussion

As required by the Commission's Rules of Practice and Procedure, Rule 51 *et seq.*, the Commission will not approve a settlement unless the settlement is reasonable in light of the whole record, consistent with the law and in the public interest (Rule 51.1(e)).

We believe that the Settling Parties have provided the Commission with a settlement that meets the public interest standards expressed in Rule 51 and in

the Commission's many decisions on settlements. Those cases express a strong public policy favoring settlement of disputes if they are fair and reasonable in light of the whole record. See, e.g., D.88-12-083 (30 CPUC2d 189, 221-23) and D.91-05-029 (40 CPUC2d 301, 326). This policy supports many worthwhile goals, including reducing the expense of litigation, conserving scarce Commission resources and allowing parties to reduce the risk that litigation will produce unacceptable results. (D.92-12-019 (46 CPUC2d 538, 553.)

We note that in representing the public interest, ORA has been directly involved in SDG&E's Gas PBR mechanism since its inception in 1993, and thus has a great deal of expertise in these matters. ORA recognizes that the mechanism has and continues to provide benefits to customers and will streamline regulation. ORA would like to continue to provide an incentive to SDG&E to maintain a strong gas procurement department. This will ensure that customers continue to receive reliable gas supplies at a low cost, while aligning both customer and shareholder interests and providing for a more efficient and collaborative regulatory process. Likewise, SDG&E states that it is proud of its achievements and performance under the Gas PBR mechanism and would like the mechanism to continue for the benefit of its customers and SDG&E alike. ORA and SDG&E, therefore agree on continuing the existing Gas PBR mechanism with certain modifications which they believe represent a reasonable balance of the competing interests.

The settlement also complies with all Commission guidelines and relevant precedents. In particular, the settlement complies with the criteria in D.92-12-019 for all-party settlements. In D.92-12-019, at p. 7, the Commission stated:

“As a precondition to our approval the Commission must be satisfied that the proposed all party settlement:

- a. commands the unanimous sponsorship of all active parties to the instant proceeding;
- b. that the sponsoring Parties are fairly reflective of the affected interests;
- c. that no term of the settlement contravenes statutory provisions or prior Commission decisions; and
- d. that the settlement conveys to the Commission sufficient information to permit us to discharge our future regulatory obligations with respect to the Parties and their interests.”

We believe the settlement complies with each of these criteria. The settlement is an all-party settlement. The Settling Parties reflect the interests of SDG&E’s customers and the utility itself and therefore fairly reflect the affected interests. The terms of the settlement comply with all statutes and decisions. Together with the formal record in this proceeding, the settlement and Joint Motion contain the information necessary for the Commission to fulfill its regulatory obligations.

Further, we believe that the settlement fairly serves the interests of SDG&E’s customers, SDG&E and the Commission itself and that the settlement is a reasonable compromise. As discussed above, continuation of SDG&E’s existing Gas PBR mechanism would (1) provide benefits to SDG&E customers through reliable gas supply at a lower cost; (2) align customer and shareholder interests through sharing of gains and losses; (3) streamline and stabilize the regulatory process and reduce the administrative cost of regulation for the Commission, SDG&E and interested parties. Furthermore, the modification to the existing mechanism’s sharing formula for gains and losses would serve to reduce the difference in shareholder benefits between periods of stable and

volatile gas prices. The modification to the benchmark utilized for Canadian gas purchases to an Alberta, Canada basin index would provide consistent treatment for non-Southwest basin gas purchases and Southwest basin gas purchases.

Therefore, for all the above reasons we conclude that the settlement, attached as Appendix B to this decision, should be adopted.

VI. Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Pub. Util. Code § 311(g)(3) and Rule 77.7(f)(9) of the Rules of Practice and Procedure. The comment period was shortened to 10 days because the existing PBR mechanism will end on July 31, 2003 and there needs to be a new mechanism in place before that date. Comments were filed on _____.

VII. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Julie Halligan is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. D.98-08-038 adopted a permanent Gas PBR mechanism for Years Five through Ten, which will end on July 31, 2003.
2. The Settling Parties reached a settlement which will allow the PBR mechanism to continue with certain agreed-upon modifications that shall apply for PBR Year Ten (August 1, 2002 through July 31, 2003) and beyond.
3. The existing sharing formula provides for 50/50 sharing of savings between customers and shareholders and that costs more than 2% above the benchmark are shared 75% to shareholders and 25% to customers. There is no shareholder reward cap under the current PBR mechanism.
4. The settlement modifies the sharing formula for savings through (1) a 100% allocation of savings to customers up to 1% below the benchmark;

(2) 75/25 sharing of savings (75% of savings to ratepayers, 25% of savings to shareholders) more than 1% below the benchmark; and (3) an annual Gas PBR shareholder award cap of the lower of 1.5% of the total commodity benchmark costs or \$6 Million.

5. The settlement also provides for a modification in the sharing of losses with a 50/50 sharing of losses above the 2% deadband.

6. The settlement provides that the benchmark for non-Southwest basin gas purchases will compare Canadian gas purchases with an Alberta, Canada basin index in the same manner than San Juan and Permian basin gas purchases are treated under the existing Gas PBR mechanism.

7. The continuation of SDG&E's existing Gas PBR mechanism would (1) provide benefits to SDG&E customers through reliable gas supply at a lower cost; (2) align customer and shareholder interests through sharing of gains and losses; (3) streamline and stabilize the regulatory process and reduce the administrative cost of regulation for the Commission, SDG&E and interested parties.

8. The modification to the existing mechanism's sharing formula for gains and losses would serve to reduce the difference in shareholder benefits between periods of stable and volatile gas prices.

9. The modification to the benchmark utilized for Canadian gas purchases to an Alberta, Canada basin index would provide consistent treatment for non-Southwest basin gas purchases and Southwest basin gas purchases.

Conclusions of Law

1. The settlement is an all-party settlement.
2. The Settling Parties reflect the interests of SDG&E's customers and the utility itself and, therefore, fairly reflects the affected interests.

3. The terms of the settlement comply with all statutes and decisions.
4. Together with the formal record in this proceeding, the settlement contains the information necessary for the Commission to fulfill its regulatory obligations.
5. The settlement fairly serves the interests of SDG&E's customers, SDG&E and the Commission itself and the settlement is a reasonable compromise.
6. The settlement is in the public interest and should be adopted.

O R D E R

IT IS ORDERED that:

1. The joint motion of San Diego Gas & Electric Company (SDG&E) and the Office of Ratepayer Advocates (ORA) is granted.
2. The settlement between SDG&E and ORA on SDG&E's Gas Performance Based Ratemaking (PBR) mechanism, attached as Appendix B to this decision, is adopted.
3. The proposed improvements and extension of the term of SDG&E's Gas PBR mechanism, are approved.
4. SDG&E's Gas PBR mechanism shall remain in effect until Commission approval of an application to modify or discontinue the Gas PBR mechanism or Commission approval of the consolidation of the SDG&E and Southern California Gas Company gas portfolios.
5. Due to the fact that, ultimately, we held no evidentiary hearings in this matter, the preliminary "hearing determination" reflected in Resolution ALJ 176-3099, is hereby changed.
6. This proceeding is closed.

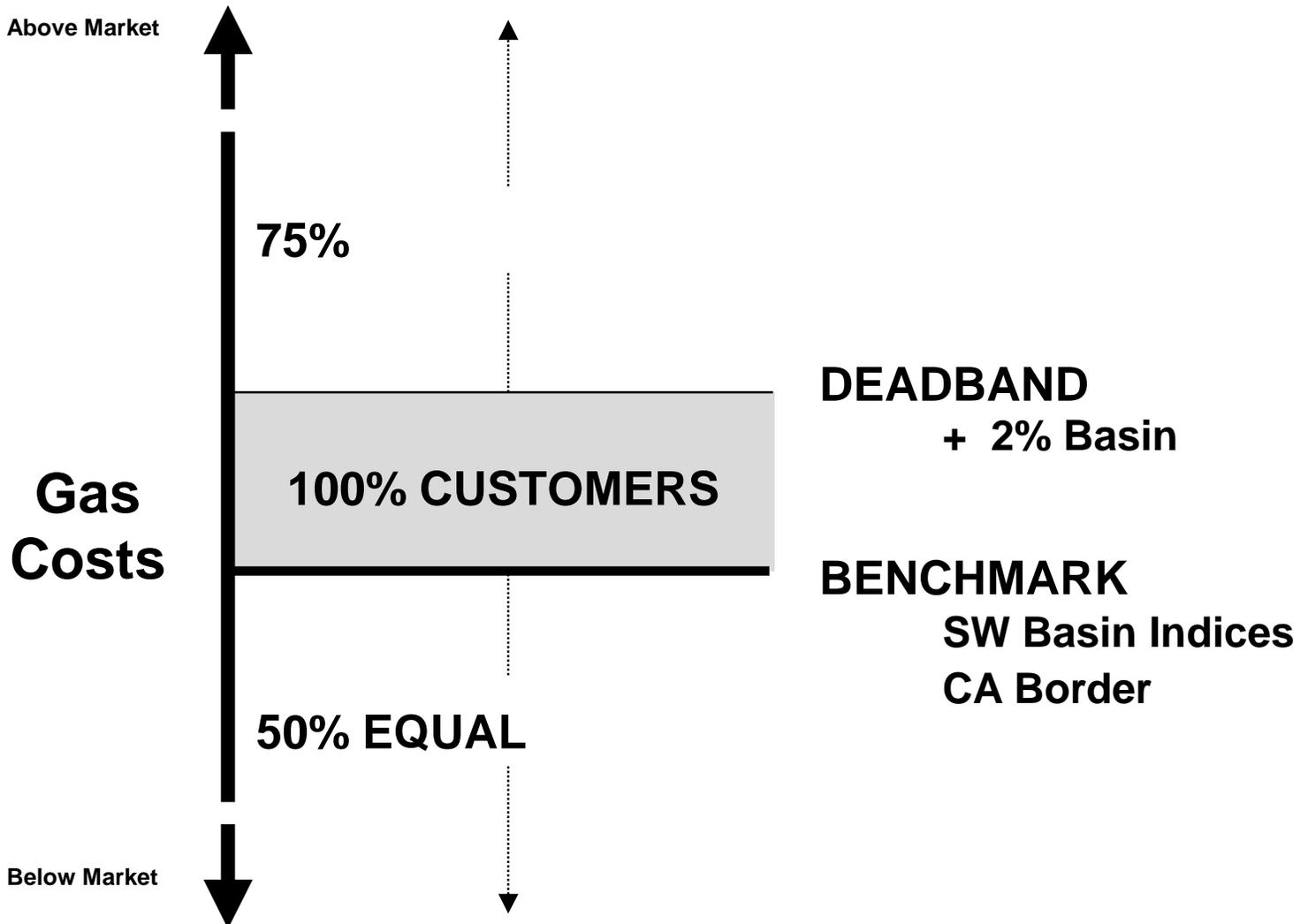
This order is effective today.

Dated _____, at San Francisco, California.

APPENDIX A

SDG&E's Gas Procurement PBR

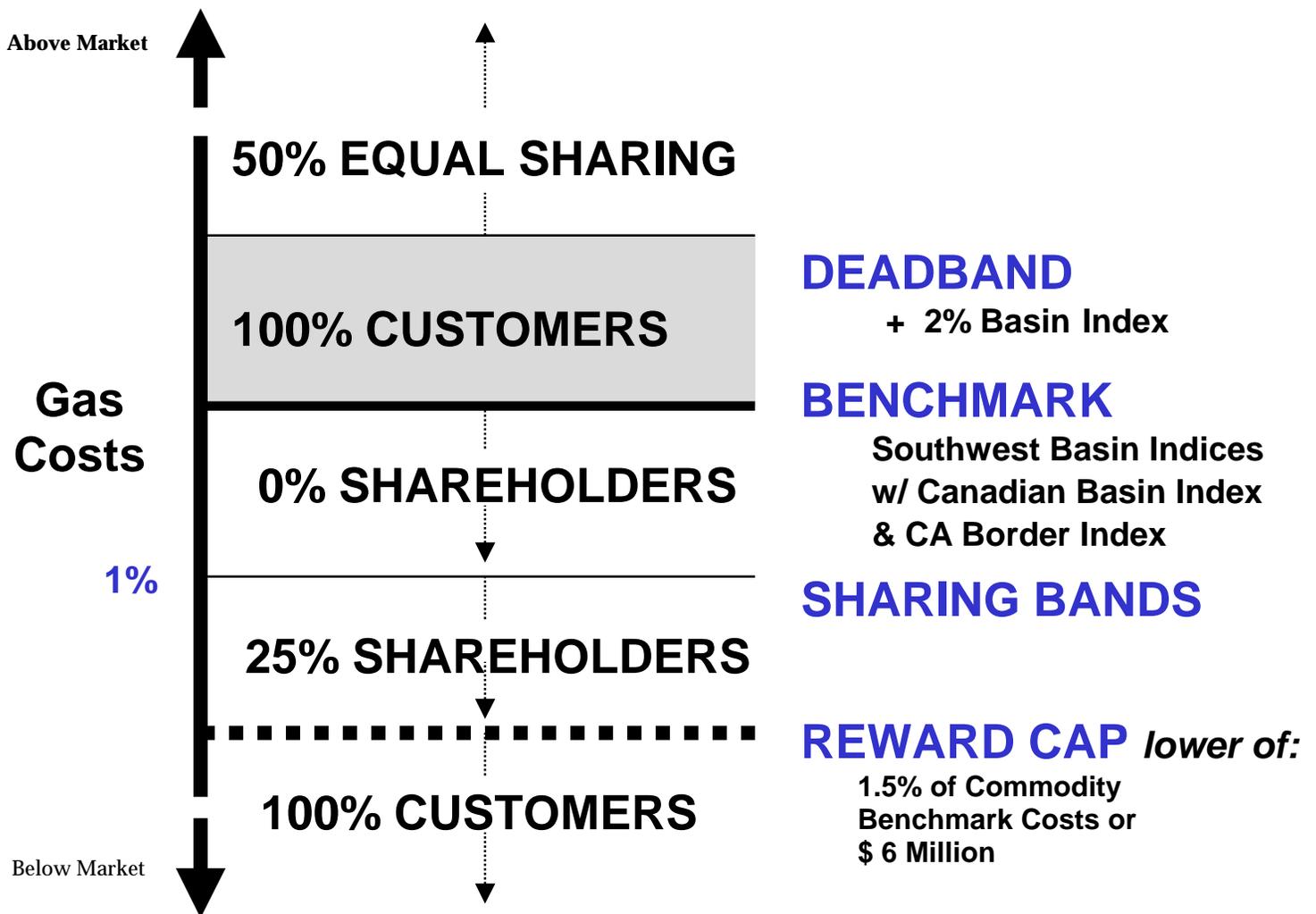
D.98-08-038 MECHANISM (Years 6 – 10)



(END OF APPENDIX A)

APPENDIX B

SDG&E's Gas Procurement PBR MECHANISM SETTLEMENT FOR YEAR-11/EXTENSION



(END OF APPENDIX B)

APPENDIX C
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SETTLEMENT AGREEMENT AMONG
SDG&E AND ORA
ON SDG&E'S GAS PBR

This Settlement Agreement has been entered into by and among San Diego Gas and Electric Company ("SDG&E") and the Office of Ratepayer Advocates ("ORA").

This Settlement Agreement addresses modifications to SDG&E's Gas Performance Based Ratemaking Mechanism ("Gas PBR") for Year 10 (August 1, 2002 through July 31, 2003) and beyond. This Settlement Agreement will promptly be submitted under joint motion of the parties to the California Public Utilities Commission ("Commission") for approval.

Continuation of the Gas PBR. As modified herein, the Gas PBR will continue on an annual basis thereafter until further modified or terminated upon Commission order and subject to the Commission's approval of the consolidation of the SDG&E and SoCalGas gas portfolios, currently pending before the Commission in A.01-01-021.

1. Consistent treatment of non-Southwest basin purchases and Southwest basin purchases. The benchmark for non-Southwest basin gas purchases will compare Canadian basin gas purchases with an Alberta, Canada basin index in the same manner that San Juan and Permian basin gas purchases are treated under the existing Gas PBR.

2. Sharing Bands.

a. Shareholder savings are determined by comparing total annual actual costs, to include gas procurement and transportation and hedging activities, with the benchmark and deadband costs. The sharing bands above the benchmark will retain a 2% deadband, resulting in no sharing up

APPENDIX C
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to 2% above the benchmark. For costs more than 2% above the benchmark, the sharing formula between ratepayers and shareholders will be modified to 50/50. If emergencies such as force majeure events (e.g. earthquakes and pipeline failures) cause the cost to be above benchmark, then ratepayers would absorb these incremental costs associated with that event. The sharing bands below the benchmark, as a percent of annual gas commodity benchmark, will be as follows:

#	Sharing Band	Ratepayer %	Shareholder %
1	0.0% -1.00%	100%	0%
2	1.00% & Above	75%	25%

b. The annual Gas PBR shareholder award will be capped at the lower of 1.5% of the total commodity benchmark costs or \$6 Million.

Reservations. This Settlement Agreement represents a negotiated compromise among the parties on a number of issues. If not accepted by the Commission, this Settlement Agreement shall not be admissible in evidence in this or any other proceeding. Nothing contained herein shall be deemed to constitute an admission or an acceptance of any fact, principle, or position contained herein by any party.

The Settlement Parties have bargained earnestly and in good faith to achieve this settlement. The Settlement Parties intend that the Settlement Agreement be treated as an entire package and not as a collection of separate agreements on discrete issues. In short, the compromises reflected in the various sections of the Settlement Agreement are closely interrelated. Accordingly, the Settlement Parties shall request the Commission to promptly approve the Settlement Agreement without modification. Any material change to this Settlement Agreement shall render the Settlement Agreement null and void.

Agreed to by the undersigned parties on the dates indicated below.

APPENDIX C
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SAN DIEGO GAS AND ELECTRIC COMPANY

By /s/ MEREDITH ALLEN

Title Attorney for San Diego Gas and Electric Company

Date May 9, 2003

OFFICE OF RATEPAYER ADVOCATES

By /s/ _____

Title Attorney for the Office of Ratepayer Advocates

Date May 9, 2003

(END OF ATTACHMENT C)