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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ENERGY DIVISION | **RESOLUTION G-3467**
April 19, 2012

R E S O L U T I O N

Resolution G-3467. Southern California Gas Company (SoCal Gas) submits its Annual Compliance Report 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 finds that SoCalGas' gas procurement activities intended to maintain Southern System reliability during the September 1, 2010 through August 31, 2011 period were in compliance with the conditions specified for such purchases and sales in Rule 41 and approves the submitted cost of the procurement activities

ESTIMATED COST: $8,314,055

By Advice Letter 4282 Filed on September 30, 2011

SUMMARY

This resolution approves the Annual Compliance Report submitted by SoCalGas as Advice Letter 4282 on September 30, 2011. The Annual Compliance Report details the natural gas procurement actions taken by the SoCalGas System Operator from September 1, 2010 through August 31, 2011 in order to maintain minimum flow requirements on SoCalGas' southern gas transmission system. Although the Annual Compliance Report is approved, the resolution finds that some transactions were inaccurately categorized. The Annual Compliance Report states that all of its spot purchases and sales were reasonable under Sections 13 and 14 of Rule 41. However, five of these purchases were inaccurately categorized as reasonable under Section 14. These transactions were made without the three offers for comparison purposes necessary under Section 14. Upon review and with explanation provided by SoCalGas these five transactions are found to be reasonable under Section 15.

SoCalGas incurred $8.3 million in gas procurement transactions to ensure Southern System reliability and made offsetting sales of $4.5 million yielding a net cost of $3.8 million.
SoCalGas' procurement transactions and sales were in compliance with the conditions specified for such transactions in Rule 41 of its tariffs.

BACKGROUND

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 Southern System requires a minimum amount (which can vary depending on conditions) of flowing supplies to operate effectively. 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 to the Utility System Operator. As required by D.07-12-019, the SoCalGas System Operator 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 system Operator to buy and sell gas on a spot basis, as needed, to maintain system reliability;
- authority and the requirement to conduct at least one annual request for offers (RFO) or open season process consistent with the System Operator needs; and
- authority to approve (sic) an expedited Advice Letter approval process for contracts that result from an RFO or open season process.

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[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.

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, SoCal Gas 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 4282, filed on September 30, 2011, SoCalGas asserts that its gas procurement activities to maintain Southern System reliability during the twelve months September 1, 2010 through August 31, 2011 were in compliance with the standards, criteria and procedures specified in Rule 41. During this period, SoCalGas incurred gas purchase costs of $8.314 million to meet Southern System minimum flow requirements. Of that amount $7.871 million was incurred under spot purchases[3]. The remaining $442,780 was purchased from Southern California Gas Company's Utility Gas Procurement Department as provider of last resort. The gas was then resold at the SoCal Citygate for $4.525 million, yielding a net cost of $3.789 million. SoCalGas Rule 41 specifies detailed criteria and processes for reasonable spot gas purchases and sales made by the Operational Hub. SoCalGas asserts that it has met the criteria and followed the necessary processes for reasonable spot gas purchases and sales detailed in
Rule 41.

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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] These spot purchases include the use of call options without reservation charges.

NOTICE

Notice of AL 4282 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 4282, which includes parties to Application 08-02-001.

PROTESTS

Advice Letter 4282 was not protested.

DISCUSSION

The Commission approves AL 4282. SoCalGas' gas procurement activities intended to maintain Southern System reliability during the September 1, 2010 through August 31, 2011 period were in compliance with the conditions specified for such purchases and sales in Rule 41. The procurement costs of $8,314,055 incurred by the SoCalGas Operational Hub were almost entirely from spot purchases including those using option contracts.[4] One purchase was made using the SoCalGas Gas Procurement Department as the provider of last resort.

The breakdown of cost by the categories is as follows:

Spot Purchases:	$7,871,275[5]
SoCalGas Gas Procurement Department:	$442,780

All of the purchases were made during a five day period, January 31, 2011 through February 4, 2011 when the Southwest and specifically the gas producing

[4] The option contracts were the result of a Request for Offers issued on September 13, 2010. Essentially, these were spot supplies at pre-negotiated prices. Since they had no reservation charges they did not require Commission approval. Based on the high cost of baseload supplies with daily reservation charges, SoCal Gas only secured call options for next day or intra-day gas at the Southern System and did not enter into baseload contracts. The spot purchases using call-option contracts represented $904,801 of the total $7,871,275 million in spot purchases.

[5] Includes $39,718 in Firm Access Rights (FAR) charges.

basins which supply SoCalGas were experiencing severe weather.[6] Throughout this period service from the El Paso Natural Gas system, the primary supply pipeline to the SoCalGas Southern System, progressively deteriorated due to upstream customer overpull and producer non-performance caused by low temperatures in the Southwest.[7] In response SoCalGas made requests for the purchase of 1,970 thousand dekatherms (MDth) in order to maintain Southern System integrity. Of this amount only 1,045 MDth were successfully purchased through the combined efforts of the Operational Hub and SoCalGas' Gas Acquisition department. The supply shortfall resulted in a localized curtailment on February 3rd and into February 4th.

SoCalGas made gas sales totaling $4.525 million on several days between February 2, 2011 and April 1, 2011. As a result of the sales the net cost for maintaining flow on the system was $3,789,043.

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 details the procedures SoCalGas must follow for the transactions to be considered

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[6] The August 2011 Federal Energy Regulatory Commission/North American Electric Reliability Corporation (FERC/NERC) Report on Outages and Curtailments During the Southwest Cold Weather Event of February 1-5, 2011 notes that "The Arctic cold front that descended on the Southwest during the first week of 2011 was unusually severe in terms of temperature, wind, and duration of the event." (Executive Summary, p. 7)

[7] The San Juan and Permian Basins which are the main supply basins for SoCalGas experienced significant production declines due to wellhead freeze-offs, e.g., Permian Basin production fell by over 50% on Feb. 4, 2011 relative to production on Jan. 31, 2011. (FERC/NERC report p. 115) Platts Gas Daily, p.2, for February 3rd, notes that "Pipeline restrictions were prominent in the Southwest, where El Paso Natural Gas reported low linepack and under-performance in both the San Juan and Permian supply basins."

reasonable. 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.

In addition, except under a specified condition[8], purchases and sales between the Operational Hub and Sempra Energy/Sempra affiliates must be made through an Independent Party, where the counterparties are not known until after the transaction is completed.

There were thirty-six spot gas purchases. As required, the purchases were made only when the Operational Hub was the provider of last resort. These transactions were equal to or less than the system reliability requests made by the System Operator. The spot purchases made by SoCalGas were in direct response to receipts below the forecast minimum requirements for the Southern System and significant supply shortfalls on the part of El Paso. These shortfalls were caused by the severe weather occurring at the time. The spot purchases supplemented SoCalGas' use of line pack in attempts to maintain the Southern System and storage to reliably operate the rest of the system. SoCalGas also made 38 sales.

Nineteen of the thirty-six purchases representing $3.253 million fell within the range of the ICE price specified in Section 13 of Rule 41. All of the sales fell within the range of the ICE price specified in Section 13 of Rule 41. SoCalGas provided information with AL 4282 and in response to Energy Division requests showing that the nineteen purchases and all of the sales complied with Section 13 of Rule 41. Five of these purchases and two of the sales were between the Operational Hub and Sempra/Sempra affiliates. Section 11 of Rule 41 requires that purchases and sales between the SoCalGas Operational Hub and Sempra/Sempra affiliates be conducted by an Independent Party where the counterparties are not known until after the transaction is completed. SoCalGas provided documentation that it met this requirement.

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[8] Section 11 does not require the use of an Independent Party in a "transaction related to the Utility Gas Procurement Department's role as 'provider of last resort'…." SoCalGas reported one direct transaction with the SoCalGas' Gas Acquisition Department as the provider of last resort which is discussed in a following paragraph.

The remaining 17 purchases representing $4.578 million fell outside the Section 13 price range. SoCalGas states that it made these 17 purchases according to the required process defined in Section 14. However, five of the 17, representing $3.771 million of the $4.578 million, do not meet all of the requirements of Section 14. These transactions are inaccurately characterized. Section 14 specifically requires that "when less than the required volumes are available on ICE, the Operational Hub shall contact gas suppliers (other than the Utility Gas Procurement Department or affiliates), request offers for the necessary supplies, and record their offers for gas delivered to the relevant trading points to ensure at least three offers from three different suppliers are available for comparison." These five transactions were made without securing three offers for comparison. Three had only one offer and the other two had only two offers.

Rule 41, Section 15, allows for transactions made outside of the Section 14 process to be deemed reasonable when supported with sufficient explanations. When requested, SoCalGas provided sufficient explanation supporting the reasonableness of the five inaccurately characterized transactions. The five transactions were made, in addition to others, in an attempt to avoid curtailments on February 2nd and 3rd, 2011. They occurred under a deteriorating weather driven situation which combined significant shortfalls in scheduled receipts with shortfalls in spot purchase deliveries.[9] As the shortfalls became known throughout the day, it was necessary to address the unexpected deficits with additional spot purchases for same day delivery. On February 2nd SoCal Gas made three spot purchases for same day delivery. In each case Operational Hub made requests first to firm capacity holders on the El Paso line who are most reliable and likely to have supply. When they were unable to deliver supplies SoCalGas expanded its efforts to include suppliers outside of those the company usually relies on for Southern System support. The utility documents a minimum of three contacts/requests for each transaction; however in each of these cases only one offer was made. The remaining contacts responded that they did not have gas available at any price. SoCalGas accepted the only offer made in an attempt to "lock in" what was available in an extremely limited market. Two of the transactions on February 2nd were particularly

[9] On February 2nd SoCalGas received approximately 80% of its spot purchase quantities. On February 3rd it received only 28% of its spot purchase quantities.

critical. They were made in response to the loss of all line pack on the Southern System. Supply was needed quickly to avoid curtailments. This situation was time sensitive and only one supplier could meet the time requirements for delivery. SoCalGas accepted two offers for same day deliveries from this single supplier.

In an attempt to meet requirements for February 3rd, the remaining two spot purchases falling outside of the Section 14 requirements were made. For the first, three contacts/requests were made for a total of 240,000 Dth. Two offers were made to supply a total of half of the requested amount and the Operational Hub accepted both offers. For the second, four contacts/requests were made and two offers were received. SoCalGas accepted the lower of the two offers.[10] Despite these purchases and others, there was a curtailment of service which began on the 3rd and extended into the 4th of February.

In addition to the spot purchases, the SoCalGas Operational Hub made one direct purchase from the SoCalGas Gas Acquisition Department as the "provider of last resort." The Operational Hub complied with the requirements of Rule 41 regarding this transaction. Section 12 of Rule 41 states that the Gas Acquisition Department will, when requested by the Operational Hub as a provider of last resort, act on a best-efforts basis to provide gas supplies. Provider of last resort "relates to the circumstance in which the Operational Hub has attempted to use all other available tools, has entered the open market for gas commodity purchases, has been unsuccessful in meeting its need to receive a required volume of flowing supplies at a specific location, and system reliability is therefore jeopardized." The Utility is required to charge the Operational Hub the actual incremental costs incurred and verification that the Utility followed this procedure is required to be included in conjunction with the Annual Compliance Report. The Operational Hub purchased gas from the Gas Acquisition Department on February 3, 2011. The request and resulting purchase was made after the Operational Hub made successive attempts at spot purchases on the market and was unable to obtain sufficient supply. SoCalGas

[10] The Operational Hub made additional requests on February 3rd and secured multiple (three or more) offers. It accepted all of the gas supply offered however was forced to implement curtailments on the 3rd which extended into the 4th.

provided verification that the Utility billed the Operational Hub for the incremental costs of this purchase in response to a data request.

COMMENTS

This is an uncontested matter in which the resolution grants the relief requested. Accordingly, pursuant to PU Code 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

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 AL 4282 on September 30, 2011 providing an Annual Compliance Report in compliance with D.09-11-006 and Rule 41.
3. SoCalGas incurred $8.314 million in procurement transaction costs to support Southern System reliability between September 1, 2010 and October 31, 2011.
4. Substantially all of the procurement costs, $7.871 million, were incurred through thirty-six spot purchases including transactions using call-option contracts.
5. SoCalGas Gas Procurement Department acted as the provider of last resort in a transaction with the Operational Hub of $442,780.
6. The Operational Hub made gas sales that resulted in a net cost of $3,789,043.
7. Seventeen of the thirty-six transactions representing $4.578 million, approximately 56% of the total gas purchases, were made through transactions outside the range of prices specified in Rule 41 for presumed reasonable transactions.
8. SoCalGas characterized all of the seventeen transactions as reasonable by virtue of having followed the specific procedures required under the Rule for transactions falling outside of the range of ICE prices.
9. Five of the 17 transactions, representing $3.771 of the $4.578 million, were inaccurately categorized -- these five did not comply with all of the required procedures specified in Section 14 of Rule 41.

10. As provided for in Rule 41, SoCalGas furnished sufficient explanation in order to demonstrate, upon review by the Energy Division, that these five transactions were reasonable.
11. Operational Hub transactions with affiliates were made through an Independent Party.
12. SoCalGas provided verification that the gas purchased from the Gas Procurement Department, acting as the provider of last resort, was charged to the Operational Hub.
13. SoCalGas AL 4282 should be approved.

THEREFORE IT IS ORDERED THAT:

1. Southern California Gas Company Advice Letter 4282 is approved.

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 April 19, 2012; the following Commissioners voting favorably thereon:

PAUL CLANON
Executive Director

MICHAEL R. PEEVEY
President
TIMOTHY ALAN SIMON
MICHEL PETER FLORIO
CATHERINE J.K. SANDOVAL
MARK J. FERRON
Commissioners