Decision **PROPOSED DECISION OF ALJ WONG** (Mailed 2/7/2011)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Gas Company (U904G) and San Diego Gas & Electric Company (U902G) to Expand Existing Off-System Delivery Authority.	Application 08-06-006 (Filed June 6, 2008)

(See Appendix A for List of Appearances.)

DECISION REGARDING THE EXPANSION OF OFF-SYSTEM DELIVERY

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Appendix A – List of Appearances

DECISION REGARDING THE EXPANSION OF OFF-SYSTEM DELIVERY

1. Summary

On June 6, 2008, San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) filed the above-captioned application. The application seeks to expand the authority of SDG&E and SoCalGas to provide off-system delivery of natural gas to all other pipeline interconnections on the same terms and conditions as authorized in Decision (D.) 06-12-031.

Today's decision authorizes SDG&E and SoCalGas to expand their interruptible off-system delivery (OSD) service to all other interconnections on the terms and conditions set forth in sections 3.3.2. and 3.4. of this decision. These terms and conditions include the following: that the offering of such service shall not result in any adverse operational impacts to on-system customers; the base rate is 5 cents per decatherm (Dth) and can be increased up to a rate cap of 15 cents per Dth, and may be discounted to as low as 1.5 cents per Dth; and any such discount is to be offered on a non-discriminatory basis.

This decision also authorizes SDG&E and SoCalGas to expand their firm OSD service to all other interconnections on the terms and conditions set forth in sections 3.3.3. and 3.4. of this decision utilizing the process proposed by the applicants and which was approved in D.06-12-031. These terms and conditions include the following: the application for firm OSD service shall provide a description of the open season process; the firm OSD rate shall consist of the two charges described in this decision; to ensure that on-system customers receive a benefit from firm OSD service, no discounting shall be allowed; the application for firm OSD service shall address how any unused firm OSD capacity a firm shipper may want to release will be traded or sold, and shall discuss the residual rights, if

any, that the firm shipper might have upon the expiration of the contract for firm OSD service; and, under appropriate circumstances, the applicants may propose in the application for firm OSD service that the firm OSD rate be rolled into the overall transmission system rate, but the test for determining whether to permit a roll-in is to be addressed in that new proceeding.

2. Procedural Background

In Decision (D.) 06-12-031, the Commission authorized San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas)[1] to provide off-system delivery (OSD) of natural gas to Pacific Gas and Electric Company (PG&E) on an interruptible basis. D.06-12-031 also authorized the applicants to file an application after May 1, 2008 to offer OSD to pipeline interconnections other than PG&E. In response to that invitation, the application in this proceeding was filed on June 6, 2008.

Timely protests and responses to the application were filed by the Division of Ratepayer Advocates (DRA), Indicated Producers, Salt River Project Agricultural Improvement and Power District, South Coast Air Quality Management District, Southern California Generation Coalition (SCGC), and Transwestern Pipeline Company, LLC (Transwestern). On July 21, 2008, the applicants filed a reply to the protests and responses.

A prehearing conference (PHC) was held on September 29, 2008, and the scoping memo and ruling (scoping memo) was issued on December 18, 2008.

The scoping memo bifurcated two legal issues from the rest of the application. As a result, the legal issues of whether the air quality and the Wobbe

[1] SDG&E and SoCalGas are also referred to in this decision as the "applicants."

Index had already been addressed by the Commission, and whether the application in this proceeding requires the preparation of an environmental impact report under the California Environmental Quality Act, were separately addressed in D.09-06-019.

The other legal issue concerns the applicants' Hinshaw exemptions under the Natural Gas Act. In authorizing the applicants to file an application for OSD to interconnections other than PG&E, the Commission expressed concern in D.06-12-031 about potential operational problems for intrastate gas transmission that could result from expanding OSD, and how the expansion to interconnection points other than PG&E could impact the applicants' Hinshaw exemptions. That issue is addressed in today's decision.

Following the issuance of D.09-06-019 and in accordance with the scoping memo's procedural schedule, a July 20, 2009 amended scoping memo was issued which established the dates for the service of prepared testimony on the remaining issues and the dates for the evidentiary hearing.

The evidentiary hearing was held on October 28 and 29, 2009. Opening and reply briefs were filed, and this proceeding was submitted on December 18, 2009.

3. Discussion

3.1. Background

SDG&E and SoCalGas operate their respective gas transmission systems in an integrated manner as allowed by D.06-04-033. SoCalGas' transmission system is interconnected with the following interstate gas pipelines: El Paso Natural Gas Company (El Paso) near Needles and Blythe; TransCanada North Baja Pipeline at Blythe; Transwestern and Questar Southern Trails Pipeline Company near Needles; Kern River Gas Transmission Company and Mojave Pipeline Company at Wheeler Ridge in the San Joaquin Valley and at Kramer Junction in the high desert; and TransCanada Gas Transmission Northwest through PG&E's intrastate system at Kern River Station in the San Joaquin Valley. SoCalGas also operates four gas storage fields which are interconnected to its transmission system. SDG&E's transmission system is interconnected to the SoCalGas system at Rainbow Station in Riverside County, and to the Transportadora de Gas Natural pipeline at the United States border with Mexico at Otay Mesa.

SDG&E and SoCalGas were authorized in D.06-12-031 to make OSD to PG&E at a rate of 5 cents per decatherm (Dth) for interruptible service, and to hold an open season to solicit interest in firm OSD to PG&E's system and to file an application for that firm service.

The applicants propose that they be authorized to expand the existing authority for interruptible and firm OSD service to all of their interconnection points with interstate and international receipt points. In their reply to the protests and at the PHC, the applicants clarified that they should be allowed to make OSD of gas to all pipeline interconnections on an interruptible basis, and that the offering of firm OSD service would follow the process approved in D.06-12-031. The applicants request that the Commission establish the general terms and conditions for firm OSD service, as well as the method for determining the firm OSD rate, in this proceeding. Under the applicants' proposal, after the holding of an open season and a contract for firm OSD service is entered into, the applicants will then file a separate application for authority to engage in firm OSD service. If such authorization is granted, this will allow shippers on the SDG&E and SoCalGas transmission systems to deliver gas into gas markets outside of California, such as Arizona and Nevada, through physical delivery or displacement.

SoCalGas and SDG&E define an "off-system" delivery as "the transfer, through displacement or actual flow, of gas supplies to customers outside of SoCalGas/SDG&E service territories." The term "on-system" deliveries "are defined as deliveries from SoCalGas/SDG&E's gas system to end-use customers within its service territories." (Ex. 1 at 1.)

For "interruptible" OSD, that service is usually accomplished by the displacement of the gas supply that is normally received at the OSD interconnection point, or from another receipt point or gas storage on the applicants' transmission systems. "Firm" OSD service is accomplished by the physical redelivery of gas supply from the applicants' transmission systems to the OSD point under all but the most extreme supply and demand conditions. Firm service does not rely on the displacement of flowing gas supplies. Instead, the gas must be physically delivered "in the direction that is opposite of the on-system delivery through that interconnection." (Ex. 2 at 6-7.)

If OSD service is authorized to receipt points other than PG&E, the Gas Scheduling Department of SoCalGas and SDG&E plans to use the same kind of scheduling and confirmation procedure that it uses for on-system receipts from PG&E, and for off-system deliveries to PG&E at Kern River Station. The Gas Control Department will then determine the level of OSD service that can be provided, while maintaining system integrity.[2] If the system integrity cannot be maintained with the nominated level of OSD services, the Gas Control Department will curtail these services in whole or in part. If the nominations

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[2] Maintaining system integrity consists of maintaining system pressures between minimum and maximum allowable limits at all times, operating transmission and storage facilities within their rated capacities, and maintaining and recovering system linepack.

exceed the capacity allowed by the Gas Control Department for OSD, the Gas Scheduling Department will reduce those nominations according to the scheduling priorities.

The applicants claim that the expansion of OSD services will provide various benefits including the following: (1) placing SoCalGas' transportation service options on equal footing with PG&E, which is allowed to provide OSD services to all of its backbone transportation paths; (2) OSD services to other SoCalGas receipt points will increase the utilization of the transmission system, which will result in increased transportation revenues that will result in lower transportation rates for on-system customers; (3) gas suppliers will be encouraged to bring additional supplies to the SoCalGas citygate, which will tend to increase gas-on-gas competition and liquidity at the citygate and benefit all California customers through lower gas and electricity prices; (4) gas storage demand will increase, which will result in ratepayers sharing in the increase in unbundled storage revenues; (5) additional balancing and price arbitrage opportunities; (6) potential reduction of compressor fuel costs; and (7) increased system capacity at a minimal cost.

3.2. Should the Application be Denied?

The ultimate issue to be addressed in this proceeding is whether the applicants should be authorized to expand interruptible and firm OSD to interconnection points other than PG&E on the same terms and conditions as set forth in D.06-12-031.

Of the parties who participated in this part of the proceeding, only SCGC believes the Commission should deny the application. All the other parties support granting the application with certain proposed changes to the rates and terms of the OSD services. If the Commission is inclined to grant the application, SCGC proposes certain changes to the rates and terms of the OSD services.

We first address SCGC's argument that the application should be denied in its entirety. This argument of SCGC raises some of the scoping memo issues about whether or not an expansion of the applicants' OSD service is warranted.

3.2.1. SCGC's Position

SCGC contends that the expansion of OSD service will not result in the benefits the applicants have suggested. SCGC refers to PG&E's experience as an example. PG&E has been authorized to provide OSD service at each of its interconnection points since 1996. SCGC's witness testified that most of PG&E's OSDs have been to SoCalGas' system as part of the expansion project bringing Canadian gas to southern California. Other volumes from PG&E's OSD service have been minimal, and in the last four years, PG&E has only made OSD to Southwest Gas and Kern River. SCGC contends that these minimal volumes conflict with the applicants' claim that significant OSD revenues will be generated on the applicants' systems. SCGC points out that SoCalGas delivered only a small amount of OSD gas to PG&E in 2009, and that there has been a lack of demand for SoCalGas' OSD service. SCGC also points out that SoCalGas has not held an open season to provide firm OSD service into the PG&E system.

SCGC further contends that the applicants' forecast of an increase in gas-on-gas competition will not materialize because the circumstances for expanding interruptible and firm OSD no longer exist. SCGC points out the west coast liquefied natural gas (LNG) projects have not materialized as first envisioned in D.06-12-031, and prior to March 2010 Sempra LNG's terminal at Costa Azul had not delivered any gas supplies to California. SCGC contends that the applicants have failed to demonstrate that there is a demand for OSD service by gas suppliers other than LNG developers.

SCGC also contends that shale gas has emerged as a major new supply source, which has led to more gas coming to the west from the Permian Basin and could lead to more gas coming from the southwest and the Rockies. Since the supplies from the Permian Basin are delivered into California to both SoCalGas and PG&E on the El Paso system, SCGC contends that California is already benefitting from gas-on-gas competition as a result of the shale gas, and thus, there is no need to expand the applicants' OSD services.

SCGC also contends that the consequences of allowing east of California customers to gain access to SoCalGas' unbundled gas storage capacity should be fully understood before such access is allowed. The first such consequence that SCGC warns of is that the expansion of OSD services could result in more demand for SoCalGas' storage assets, which may lead to additional imbalances and exacerbate minimum flow conditions. Under SoCalGas' proposal, OSD customers would be allowed to use SoCalGas' storage facilities without any limitations. SCGC notes that if power plants in southern Nevada and northern Arizona are required to balance their burns with scheduled quantities, they could purchase SoCalGas' unbundled gas storage and nominate deliveries off-system to balance their loads. SCGC cautions that if the demand for storage substantially exceeds the capacity of the gas storage resources, that very high prices for unbundled gas storage services could result.

SCGC contends that a significant demand for OSD services from east of California customers could result in the expansion of gas storage, which could lead to the second consequence of reducing the amount of unbundled storage revenues that are shared with SoCalGas' ratepayers under the unbundled storage sharing mechanism. This could occur as a result of adding storage expansion costs to the existing cost of unbundled storage, which may reduce storage prices as a result of the increased storage capacity.

SCGC contends that the third consequence of the applicants' OSD proposal is it could result in a significant amount of imbalance which would benefit OSD customers. Under the applicants' proposal, OSD customers would have up to ten days to resolve their interday imbalances. SCGC states that these interday imbalances can occur as a result of a deviation on either the upstream or downstream pipeline involved in the OSD transaction during Cycle 4, where the amount of gas the OSD shipper is bringing in does not match the amount that the shipper can deliver off-system. Since OSD customers do not contribute toward the cost of the load balancing resources, SCGC contends these off-system customers would get a free ride for whatever balancing services they require, and existing on-system customers would end up paying the cost of carrying this imbalance for up to 10 days.

SCGC contends that a fourth consequence of the OSD proposal is that it could impact the minimum flow conditions, especially on SoCalGas' Southern System. This could occur because providing interruptible OSD services at each interconnection point involves service by displacement, which reduces the amount of natural gas flowing into SoCalGas' system at that interconnection point. If the interconnection point periodically experiences minimum flow problems, providing OSD services at this particular point could create or exacerbate the minimum flow situation. This could result in SoCalGas having to purchase additional gas supplies or taking other measures which could increase costs to existing on-system customers.

3.2.2. Position of the Applicants

The applicants contend that the Commission should not delay the approval of the application as SCGC recommends. If the Commission waits until concrete forecasts of the OSD quantities are available, this could result in a delay of up to 18 months before SoCalGas and SDG&E could offer OSD services. The applicants contend that the regulatory authority should be put in place so they can take advantage of potential market opportunities. According to the applicants, approving their request for expanded OSD service would allow them to "anticipate customers' future needs and take actions to catalyze the development of new markets." (Ex. 3 at 4.)

The applicants also contend that since the request for expanded OSD service is not subsidized by on-system customers and such service will not have an adverse impact on the existing services provided to on-system customers, that SCGC's request for a delay is not warranted. All of the OSD services, whether firm or interruptible, will only be offered "to the extent that system integrity and service to on-system customers are not jeopardized," and "will be secondary in priority to all on-system demand and services, including on-system interruptible services." (Ex. 1 at 4.)

In response to SCGC's argument that the applicants have failed to present a case for a need to expand OSD, the applicants contend that the evidence shows, and other parties acknowledge, that the applicants' OSD proposal will create new gas (and gas-fired electric) market opportunities that will benefit both on- and off-system customers with no degradation to existing service. The applicants contend that given the diverse group of stakeholders, the proposed OSD service will meet the existing or anticipated needs of the market.

In addition, if SoCalGas is not at risk for its backbone transmission facilities, SoCalGas proposes to use the additional OSD revenues to reduce transportation rates for its on-system, end-use customers.[3]

As for SCGC's argument that there is little or no demand for any OSD service to PG&E, the applicants point out that SCGC's own witness admits that OSD service has been provided at the interconnection with PG&E every year since it was first authorized. The applicants also contend that SCGC's analysis of demand for OSD service from SoCalGas at other interconnection points is flawed because SCGC improperly attempts to equate that demand with the OSD demand at the PG&E interconnect. The applicants contend that the demand at any particular point is a reflection of the market conditions behind each point, the supplies available to serve that market, and the constraints that may exist.

Regarding SCGC's argument about the lack of LNG facilities on the west coast, the applicants contend this only highlights the difficulty of predicting gas supply and demand in the domestic and international markets. The applicants point out that the Costa Azul LNG terminal is operating on the west coast, and that the Commission has recognized that gas suppliers have the ability to access markets on the SDG&E and SoCalGas systems. The applicants contend that LNG is just one supply source and additional sources can come from California or other domestic production. The applicants further state that the Commission should not

[3] In D.09-11-006, the Commission approved a settlement of the Phase Two issues in the cost allocation proceeding of SDG&E and SoCalGas which provides, among other things, that SoCalGas will not be at risk for backbone transmission revenues for the term of that cost allocation period.

wait until a crisis or gas shortage before approving proposals that attract additional gas supplies to the state.

The applicants contend that allowing OSD to be expanded to other interconnection points could increase the demand for SoCalGas' unbundled storage service. For example, an off-system customer could buy gas and gas storage during the summer months, and then nominate that gas for OSD during the winter months. Since SoCalGas' ratepayers and shareholders share the unbundled gas storage revenues, the increase in demand for gas storage will benefit ratepayers, and could lead to the expansion of gas storage in southern California.

As for SCGC's argument that OSD may cause shipper imbalances, the applicants contend their proposal incorporates a method that accounts for the rare possibility that a shipper's OSD will generate an imbalance on its off-system contract. The applicants propose to track any shipper OSD imbalance in an administrative account, and the customer incurring the imbalance will be instructed to clear the imbalance as soon as practicable but no later than 10 calendar days. The applicants are willing to impose a shortened imbalance clearing period of two to three days to address and resolve the concerns about possible shipper OSD imbalances.

Regarding SCGC's claim that expanded OSD service will jeopardize Southern System reliability, the applicants assert that there will be no impact to the Southern System minimum flow requirement or to any other flowing supply requirement. That is because the System Operator will establish interruptible volumes at levels that will ensure no adverse impact from the service. For example, OSD at Blythe will be set at zero if there is any danger that such a delivery will create a minimum flow issue at that point. In addition, off-system deliveries will not be allowed if they result in any additional costs for ratepayers to address a minimum flow requirement at Blythe or any other receipt point.

The applicants also request that the reference to SoCalGas' Schedule No. GIT (Interruptible Interutility Transportation), and the reference to that schedule in SoCalGas' Rule 23, be eliminated. The applicants point out that Schedule No. GIT is no longer applicable since the Commission has authorized OSD service to PG&E.

3.2.3. Discussion

In deciding whether the application should be denied outright, we need to discuss the issues that were identified in the July 20, 2009 amended scoping memo. These issues can generally be categorized into the topic of whether the applicants have justified an expansion of the OSD services. These issues are: (1) is there a need for, and what are the benefits of expanding OSD services to interconnection points other than PG&E; (2) at which interconnection points will expanded OSD occur; (3) what impact will expanded OSD services have on the daily operations of the applicants' intrastate transmission system; (4) what is the approximate cost associated with allowing the applicants to expand their OSD service; and (5) how will the expanded OSD services impact the price of, and the availability of, gas storage in southern California.

With regard to the need for, and the benefits of expanding OSD services, SCGC asserts that such an expansion will not result in the kinds of benefits the applicants claim will occur. SCGC points out that the demand for PG&E's OSD services has been minimal and the applicants' claim of an increase in transportation revenues will not materialize. Although the demand for OSD services may be low at present, there are two factors the applicants believe the Commission should keep in mind. First, SoCalGas is simply seeking the same kind of OSD authority that PG&E already has. And second, it is difficult to predict what the future gas demand, source of gas, and market conditions will be like.

PG&E was previously authorized in the Gas Accord market structure decisions to provide interruptible and firm OSD services to all of its pipeline interconnections. According to SCGC's own witness, "PG&E has been providing OSD services at each of its interconnection points since 1996…." (Ex. 4 at 2.) In D.06-12-031, SDG&E and SoCalGas were authorized to provide OSD service to PG&E on an interruptible basis. According to the applicants' witness, interruptible OSD deliveries have been made from SoCalGas to the PG&E interconnect. SDG&E and SoCalGas were also authorized in D.06-12-031 to conduct an open season to solicit interest in firm OSD service to PG&E and to file an application for the offering of such service. D.06-12-031 also authorized SDG&E and SoCalGas to file the application that is presently before us to expand its OSD service to pipeline interconnections other than PG&E.

Allowing the applicants to offer OSD service to all of its pipeline interconnections will provide the applicants with the flexibility to readily respond to gas demand needs in markets east of California, give the applicants the same kind of authority that PG&E currently has, and increase the utilization of the applicants' transmission facilities. Interruptible and firm OSD services also allow shippers to meet off-system demand if they can deliver gas supplies to an OSD point at a lower price. Lower gas prices for electric power plants in Arizona or Nevada could lead to lower electricity prices for electricity customers in southern California. In addition, any increase in revenues from the expansion of OSD services will be used by SoCalGas to reduce the transportation rates for its on-system customers. We agree with the applicants that if we deny their request now to expand their OSD service to other interconnection points, that this will delay having a regulatory structure in place to respond to the future gas demands of off-system customers should those needs arise. Also, expanding applicants' OSD authority will allow shippers to ship gas supplies to off-system markets and open up new market opportunities.

That brings us to the impact on the daily operations of the applicants' intrastate transmission system, and the cost impact, if OSD services are expanded. Since the firm and interruptible OSD services are to be second in priority to all on-system demand and services, we do not believe that allowing SoCalGas and SDG&E to expand their OSD services to other interconnection points will have an operational impact on the on-system customers, on the applicants' ability to have available supplies of gas to meet their on-system customers' needs and services, or on applicants' transmission facilities.[4] SoCalGas and SDG&E plan to set the interruptible OSD volumes at levels to ensure there will be no adverse system impact from the service, and OSD service will "not be allowed if they would result in any additional costs for ratepayers by forcing the exercise of supply contracts or other tools approved by the Commission to address the Blythe (or any other receipt point) minimum flowing supply requirement." (Ex. 2 at 7.)

In addition, since interruptible OSD service uses the displacement of flowing supplies, SoCalGas will incur negligible operational costs to provide this service. These negligible costs involve the modification of SoCalGas' nomination

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[4] This is reflected in the proposed modifications to SoCalGas Rule No. 23, which provides that in the event operating conditions require the curtailment of service, both interruptible and firm OSD services will be curtailed before any intrastate transportation or storage withdrawal services are curtailed. (Ex. 2 at 11-12.)

and scheduling system to accommodate OSD nominations at these other receipt points.

As for the cost of firm OSD service, those costs would be borne by the shippers who want the firm OSD service.

The issue about the impact on gas storage has to do with the possible demand for gas storage as a result of the expansion of OSD. The increase in demand for gas storage may reduce the amount of unbundled gas storage capacity available to on-system customers, and may increase the rate for gas storage. SCGC raised these same concerns when the Commission first authorized the applicants to provide OSD services to PG&E in D.06-12-031. In rejecting SCGC's proposal in that proceeding to prohibit the use of SoCalGas' gas storage facilities to support OSD services, the Commission stated that if storage revenues are maximized, that SoCalGas' ratepayers will be entitled to a share of the increase in unbundled storage revenues. The Commission also stated that if the demand for storage exceeds the amount of available gas storage, that this will drive the need to expand gas storage facilities. (See D.06-12-031 at 118-119.) This same logic still applies to the expansion of OSD services to other interconnection points, and we do not agree with SCGC that we should delay the expansion of OSD services based on these gas storage impacts.[5]

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[5] D.08-12-020 approved a settlement of the Phase One issues in the cost allocation proceeding of SDG&E and SoCalGas that addressed, among other things, the sharing of unbundled gas storage revenues and how unbundled storage expansion costs and revenues will be treated. Under that adopted gas storage revenue sharing mechanism, SoCalGas has an incentive to maximize the sale of unbundled storage revenues since it retains a share of those revenues up to a cap of $20 million. As for ratepayers, they also share in the revenues and have the potential to keep all of the net unbundled storage revenues if the revenues exceed $60 million. In addition, any expansion of unbundled

Footnote continued on next page

Based on the reasons summarized above, we do not see any merit in SCGC's request that the application be denied. Instead, we conclude that SDG&E and SoCalGas should be allowed to expand their OSD services to all of their interconnection points with interstate and international receipt points on the terms and conditions as described in section 3.3. of this decision. Based on the information presented in this application, and the complex interactions involving the west coast gas marketplace, we believe that providing this authority now, rather than denying the applicants' request and having them re-file the same kind of application in the future, is a more effective regulatory approach and a more efficient use of the parties' and our time. Accordingly, SCGC's request to deny the application is denied.

The applicants' request to eliminate the reference in SoCalGas' Rule No. 23 to SoCalGas' Schedule No. GIT, and to eliminate Schedule No. GIT is granted. That schedule is no longer needed since the Commission authorized interruptible OSD service to PG&E in D.06-12-031.

3.3. Terms and Conditions of Expanded OSD

3.3.1. Introduction

The sections which follow set forth the terms and conditions under which SDG&E and SoCalGas may engage in interruptible and firm OSD to other interconnection points. Some of the issues that the parties raised are common to both interruptible and firm OSD services, and are discussed in the interruptible section first.

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gas storage, and the revenues from the expanded storage, will be subject to the same sharing mechanism.

3.3.2. Interruptible OSD

3.3.2.1. No Adverse Impacts

We first address the concern of some of the parties that the OSD service should not be subsidized by on-system customers, and that the OSD service should have no adverse impact on the existing services that are provided to on-system customers.

The concern that on-system customers will end up subsidizing the cost of the interruptible OSD service is addressed in section 3.3.2.2. We also discussed in section 3.2.3. that SDG&E and SoCalGas will not offer interruptible OSD service if it will result in additional costs to on-system customers. Also, since interruptible OSD service involves the displacement of flowing supplies, the operational costs of providing interruptible OSD service should be negligible. Accordingly, the offering of interruptible OSD by the applicants shall not result in any increased costs being passed on to on-system customers.

As we discussed in sections 3.1. and 3.2.3., we do not anticipate that the offering of interruptible OSD service will result in adverse operational impacts on the existing transmission and storage services provided to on-system customers. For interruptible OSD service to occur, the displacement of flowing supplies will need to take place, and system integrity on the transmission system will need to be maintained. If system integrity cannot be maintained with the nominated level of interruptible OSD service, or if the level of nominations exceeds the capacity of the transmission line, the applicants will be required to curtail or reduce the interruptible OSD nominations.

As for the possible impact on gas storage from interruptible OSD service, we do not believe that this will drive up the price of gas storage as SCGC asserts it will. Instead, if the demand for gas storage increases as a result of interruptible

OSD service, this should encourage the development of additional gas storage in southern California.

Accordingly, the offering of interruptible OSD shall not result in any adverse operational impacts to on-system customers.

3.3.2.2. Interruptible Rates

The applicants propose that the maximum tariff rate for interruptible OSD service be equal to the Firm Access Right (FAR) charge, which is currently set at 5 cents per Dth.[6] The applicants contend that this same approach is used for PG&E, where the off-system rates are equal to the on-system rates for each of its backbone transmission paths.

The applicants also propose that they be allowed to discount the interruptible OSD rate in order to encourage the use of the service, and to maximize off-system revenues for the benefit of ratepayers by increasing gas throughput. The applicants recommend that they be allowed to discount the rate to as low as the applicants' short run marginal cost (SRMC), which the applicants contend is no lower than the cost of the average transmission fuel rate (i.e., compressor fuel) which is currently 1.5 cents per Dth.

All of the active parties agree there should be a cap on the interruptible OSD rate. However, the parties disagree on what the level of the cap should be. The applicants propose that the cap be equal to the actual FAR charge, which is currently 5 cents per Dth but which the applicants estimate may rise to 11.63 cents

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[6] The amount of the FAR charge is being examined in Application (A.) 10-03-028. The applicants propose that if the FAR charge is increased in A.10-03-028, that the interruptible OSD rate also increase to the same amount. SCGC also supports linking the interruptible OSD rate to the FAR charge.

per Dth if the FAR charge is changed to reflect the full costs of the backbone transmission system. SCGC supports the applicants' proposal.

SCE contends that the applicants' proposal to cap the OSD rate at the FAR charge is inappropriate and inconsistent with D.06-12-031. SCE points out that it is just a coincidence that the OSD rate of five cents per Dth set in D.06-12-031 is the same as the 5 cents per Dth FAR charge. SCE asserts that the Commission did not intend to set the OSD rate in D.06-12-031 as equal to the FAR charge, or that the OSD rate should move in lockstep with the level of the FAR charge. SCE points out that the FAR charge is very different from the OSD rate in that the FAR and OSD services impact different parts of the system and have different cost impacts on the system. SCE therefore recommends that the Commission adopt a rate cap of 5 cents per Dth for OSD, and that the cap not fluctuate with the FAR charge. SCE further recommends that this rate cap on the OSD rate be evaluated in the next cost allocation proceeding after more experience with the OSD market.[7]

DRA supports the applicants' proposal to expand interruptible OSD service. However, DRA contends that the interruptible OSD rate should be distinguished from the FAR charge because the FAR charge is to reserve receipt point access on the transmission system, while the interruptible OSD rate is for making an OSD. Due to this distinction, DRA disagrees with the applicants' proposal that the interruptible OSD rate should be capped at 5 cents per Dth, or whatever the current FAR charge is. DRA recommends that a price cap of 25 cents per Dth be

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[7] As an alternative, SCE suggests that the rate cap for OSD be examined in the 18 month FAR update proceeding, which SoCalGas and SDG&E filed on March 29, 2010 in A.10-03-028. Since the August 19, 2010 scoping memo in A.10-03-028 did not expand that proceeding to include a review of what the rate cap for OSD service should be, we decline to adopt this alternative suggestion of SCE.

adopted for the interruptible OSD rate. With a higher price cap, DRA believes that ratepayers will benefit by receiving the highest value for interruptible OSD service.

The applicants believe that establishing a cap higher than SCE's proposal and lower than DRA's proposal is reasonable and appropriate.

Regarding the applicants' discounting proposal, DRA agrees that the interruptible OSD rate should be discountable, but the discount should not be lower than a floor amount that covers the cost of compressor fuel, any incremental operations and maintenance costs, any incremental administrative and general costs, and the cost of any natural gas that is purchased to maintain system reliability in the event the applicants are unable to curtail the interruptible OSD service.

The Indicated Producers recommend a floor rate of 1.5 cents per Dth. The Indicated Producers contend that this floor rate will prevent the applicants from charging a rate that is less than the cost of providing the interruptible OSD service, and will prevent the cost of providing this service from being shifted to on-system customers.

SCE agrees in principle with the applicants' recommendation that the floor rate be set at the SRMC of an OSD. According to the applicants' witness, this SRMC is, at most, the average transmission fuel rate, which is estimated at 1.5 cents per Dth and is based on the average transmission fuel rate in 2008 and 2009. Given the volatility in the cost of natural gas, SCE recommends that the most recent citygate price, as quoted in Gas Daily, be used to calculate the OSD floor rate. This recommendation would allow the floor on the discount to be set lower or higher, depending on the most recent natural gas price.

SCGC recommends that the applicants be prevented from any discounting of the interruptible OSD rate. SCGC believes that the 5 cents per Dth rate is already discounted below the cost of the applicants' backbone transmission system, and should not be discounted further. SCGC also points out that since the interruptible OSD service is available on a daily basis and does not require a long-term contract, "it is difficult to create a mechanism for determining whether or how much SoCalGas should be discounting." (Ex.5 at 6.) If the Commission allows discounting of the interruptible OSD service, SCGC contends that the floor rate be set at the sum of the long run marginal cost (LRMC) for the backbone transmission system and the SRMC of the compressor fuel. When these two are added together, SCGC estimates that the amount is very close to the 5 cents per Dth rate, and therefore no further discounting is needed. If discounting of the interruptible OSD rate is permitted, SCGC recommends that the discounts be made available to all prospective shippers on a non-discriminatory basis at any given receipt point.

We first address whether there should be a rate cap on the interruptible OSD rate. The applicants favor tying the interruptible OSD rate to the FAR charge, while SCE recommends a rate cap of 5 cents per Dth and DRA suggests a rate cap of 25 cents per Dth.

We agree with DRA that the interruptible OSD rate should not be tied to the level of the FAR charge. In D.06-12-031, the Commission adopted a fixed rate of 5 cents per Dth for interruptible OSD to the PG&E interconnection. This fixed rate was not tied to the level of the FAR charge. Instead, in adopting the 5 cents per Dth rate, the Commission stated that this "amount will encourage off-system service, as opposed to a higher rate, and it also recognizes that the shipper requesting the off-system service on a backhaul basis does not place as much of a cost burden on the SoCalGas system." (D.06-12-031 at 117.) The Commission also decided in D.06-12-031 that a 16 cents per Dth rate was too high, and would likely discourage potential shippers from wanting to make an off-system delivery to PG&E.

To encourage interruptible OSD, the base rate for such service should be set at 5 cents per Dth. We will also allow this interruptible OSD rate to be raised to a maximum of 15 cents per Dth. DRA's recommended rate cap of 25 cents per Dth is too high, and is likely to discourage a shipper from making an interruptible OSD. Allowing the rate to be raised to the 15 cents per Dth rate cap will increase the amount of OSD revenues should the market demand for OSD services increase. This in turn will help to reduce rates for existing on-system transmission customers. The parties may revisit the base rate and the rate cap for interruptible OSD in the applicants' cost allocation proceeding that is filed after January 1, 2013, once more experience with such deliveries has occurred.

The next interruptible OSD rate issue is whether such a rate should be subject to discounting, and if so, should a rate floor be established.

SCGC opposes the discounting of the interruptible OSD rate, while other parties favor discounting. We agree that discounting of the interruptible OSD rate should be permitted, and that the discounting of the interruptible OSD service to a given receipt point should be done on a non-discriminatory basis. Allowing the discounting of the interruptible OSD rate will encourage potential OSD shippers to use this service, which in turn will maximize the use of the transmission system. The discounting on a non-discriminatory basis will ensure that all similarly situated shippers are treated the same. To ensure non-discriminatory treatment, the applicants shall be required to define in their interruptible OSD service tariff that a "similarly situated" shipper means those shippers using a given receipt point on a given day. The applicants shall also be required on a daily basis to post all interruptible OSD discounts, and shall offer the same discount to other similarly situated shippers using such service.

By allowing the interruptible OSD rate to be discounted, that raises the issue of whether a floor rate should be established. The parties who favor a floor rate do so in large part to ensure that the interruptible OSD rate is not lower than the cost of providing such service and that existing on-system customers are not subsidizing OSD services. We agree that on-system customers should not have to subsidize interruptible OSD service. We adopt a floor rate of 1.5 cents per Dth for the interruptible OSD rate in this proceeding. This adopted floor rate is based on several parties' estimate of the SRMC of providing OSD. We decline to adopt the proposal of DRA and SCE to adjust the floor rate on a monthly basis using monthly gas prices. Instead, parties may reexamine the level of the floor rate in the applicants' cost allocation proceeding that is filed after January 1, 2013.

Thus, for interruptible OSD service, the rate can range from 5 cents per Dth to the rate cap of 15 cents per Dth. Any discounting of the interruptible OSD rate can go as low as 1.5 cents per Dth, and any discounting is to be offered on a non-discriminatory basis.

3.3.2.3. Southern System Reliability Costs

The applicants, SCGC and SCE note that OSD deliveries from SoCalGas' Southern System will require slightly different treatment due to certain operating conditions on that part of the SoCalGas system. These conditions require a certain minimum amount of gas to flow through the southern portion of the system in order to serve customers who are located in the counties of Riverside, Imperial, San Diego, and southern San Bernardino. To meet this minimum flowing supply requirement, enough gas must be received into the Southern System at the

Blythe/Ehrenberg and Otay Mesa receipt points. SoCalGas contracts with several suppliers to bring gas in on the Southern System either on a full-time basis or on an as-needed basis. SoCalGas may also purchase gas at the border to meet its needs. The cost of bringing the gas onto the Southern System is charged to all customers on an average year throughput basis in the System Reliability Memorandum Account (SRMA).

Since interruptible OSD service is provided through displacement, this service could reduce the amount of gas flowing into SoCalGas' Southern System. This could result in a situation that creates or exacerbates a minimum flow situation.

The applicants, the Indicated Producers, SCGC and SCE all agree that OSD from the Southern System should not be permitted if such a delivery will endanger the SoCalGas system or require SoCalGas to purchase additional supplies to maintain system integrity. SCE recommends that the Commission require that no OSD from the Southern System take place if SoCalGas will be required to purchase additional supplies on the Southern System (or at any receipt point or points) to protect system integrity. This SCE recommendation is similar to SCGC's recommendation that the applicants' tariff clearly state that OSD service will be curtailed if it creates or worsens Southern System minimum flow conditions. The applicants are willing to include such a provision in their tariff. Accordingly, we will require that the interruptible and firm OSD service on SoCalGas' Southern System be curtailed if it creates or worsens a minimum flow condition or it imposes other operational costs to on-system customers, and SoCalGas shall revise its tariff accordingly.

A situation could arise whereby an interruptible or firm OSD on the Southern System will require SoCalGas to purchase additional gas supplies in order to maintain system integrity on the Southern System. To ensure that on-system customers do not end up paying for the additional purchases of gas that benefit OSD customers, SCE proposes that the revenues from OSD from the Southern System first go to pay for the fixed deliveries for the day, to offset the SRMA costs. After that, any revenues over and above the day's SRMA cost would then be credited through the Interstate Transportation Balancing Account (ITBA) for sharing purposes. The applicants are agreeable to such a requirement.

Accordingly, to prevent on-system customers from having to pay for gas purchases to maintain system integrity on the Southern System as a result of interruptible or firm OSD, SoCalGas shall reflect in its tariff that the revenues from OSD from the Southern System first go to pay for the fixed deliveries for the day to offset the SRMA costs, and any revenues over and above the day's SRMA costs then be credited to the ITBA for sharing purposes.

3.3.2.4. Shipper Imbalances

The applicants originally proposed that if a gas imbalance occurs following the Cycle 4 gas nomination process, that an OSD shipper be given ten calendar days to clear the imbalance. According to the applicants, an imbalance could result from a mismatch in the amount of gas coming from an interconnecting pipeline. The applicants propose to create an administrative shipper imbalance account to resolve any imbalances that may result from a shipper's nomination for an OSD. The applicants subsequently agreed to reduce the time to clear the imbalances to two to three business days instead of the ten days.

The Indicated Producers contend that the applicants' OSD shipper imbalance proposal, as originally proposed, must be changed to ensure that OSD shippers do not rely on on-system resources for an unreasonable period of time. The Indicated Producers point out that OSD customers do not contribute to the resources needed for load balancing, and therefore should not be allowed to use on-system balancing resources for an extended period of time. Under the applicants' proposal, shipper imbalances on the system would be allowed even on days when operational flow orders are called, while other end-use customers would be subject to daily balancing. Instead of the applicants' ten day imbalance shipper rule, the Indicated Producers recommend that the Commission adopt a rule which allows shippers two business days to resolve the resulting imbalance after Cycle 4 and the scheduling of gas by the interconnecting pipeline.

SCGC agrees that the OSD shipper imbalances should be resolved within two to three business days.

The original 10 day proposal of the applicants to resolve a shipper imbalance provides too much time to take corrective action. For interruptible and firm OSD, we will require that all OSD shippers resolve their imbalances within three business days If the imbalance is not resolved within that time period, then the imbalance is to be resolved in accordance with the terms of SoCalGas' Schedule G-IMB tariff.

Another imbalance issue concerns minor imbalances that can result from the simultaneous confirmation and scheduling processes that occur. These imbalances usually occur in the last nomination cycle of the day when there is no additional nomination opportunity to correct the difference. In order to mitigate this imbalance problem, SCGC recommended that the OSD customers be required to nominate initially to a pool or storage account instead of from a receipt point access (G-RPA) account. SoCalGas' witness was receptive to such a change. Accordingly, SoCalGas shall revise its Schedule G-RPA tariff so that a G-RPA customer will be required to nominate to a pool account or storage account before the customer can nominate to an OSD account.

3.3.2.5. Treatment of Interruptible OSD Revenues

The applicants propose that the net savings, i.e., the interruptible off-system revenues less the interruptible off-system costs, be allocated to SoCalGas' ratepayers. The applicants contend that this is the same type of revenue treatment that is in place for interruptible OSD service to the PG&E system. No one objected to this proposed treatment.

One of the benefits of expanding OSD service is that the applicants propose to use the incremental revenues to offset transmission costs for on-system customers. It is our belief that allowing the interruptible OSD rate to float up to a rate cap of 15 cents per Dth, and to be discounted to as low as the floor rate of 1.5 cents per Dth, will encourage the use of interruptible OSD, while maximizing the revenues to help reduce the transmission costs for on-system customers.

The applicants' proposal to allocate the net savings from the interruptible OSD service to on-system customers is adopted.

3.3.2.6. Affiliate Transactions and Reporting

The Indicated Producers recommend that two measures be adopted to increase the transparency of OSD transactions with the applicants' affiliates, in particular, those affiliated entities who market LNG that is imported through the Costa Azul LNG terminal.

The Indicated Producer's first recommendation is that the applicants be required to disclose all of the discounted OSD transactions with its affiliates within 24 hours. The disclosure of the affiliate discount should list the name of the affiliate purchasing the OSD service, the transaction price, the identity of the receipt point, and the quantity of gas transported for the affiliate. The Indicated Producers contend that requiring the utilities to post discounted OSD transactions with their affiliates is consistent with the Commission's affiliate rules, which require notice of discounts to affiliates be provided as promptly as 24 hours.

The second measure that the Indicated Producers recommend be adopted is that the OSD tariff define the term "similarly situated shippers," and that the tariff state that the curtailment procedures shall treat all OSD alike. The Indicated Producers contend that defining the term "similarly situated shipper" will ensure that all shippers using the same OSD receipt point will receive the same discount regardless of the contracted quantities or the length of the applicable contracts. The provision about the curtailment procedures will ensure that a curtailment of OSD will be done on a proportional basis, and will be based solely on the relative quantity of gas transported through an OSD receipt point.

This second recommendation of the Indicated Producers has already been incorporated into the terms and conditions of interruptible OSD service as discussed in section 3.3.2.2.

With respect to the first recommendation that the transactions with the applicants' affiliates be posted within 24 hours, we agree with the Indicated Producers that the affiliate rules require the posting of such information. A review of the affiliate transaction rules, which were adopted in D.98-08-035, reveal that if a "discount, rebate, or other waiver of any charge or fee" is provided to an affiliate, then an affiliate discount report must be filed as required by section III.F. of the affiliate transaction rules. In addition, under section III.B.2. of the affiliate rules, if a discount is offered to the utility's affiliate, "the utility shall contemporaneously make such discount or waiver available to all similarly situated market participants." Accordingly, any discounting of the OSD charge shall comply with those two provisions of the affiliate transaction rules.

DRA recommends that the Commission require the applicants to submit quarterly reports to the Commission and to interested parties on their interruptible OSD service. DRA recommends that the report be in the form of an Excel spreadsheet, and that it contain the following information about the total number of daily transactions at each receipt and delivery point: the date of the transaction; the prevailing city gate prices; the discounted interruptible OSD rates established by SoCalGas; the number of interruptible OSD transactions; the daily interruptible OSD volumes at each receipt/delivery point; and the maximum OSD volume capability at each receipt/delivery point without having to procure additional gas to ensure system integrity. DRA also recommends that the report separately list the transactions with the applicants' affiliates, and that the affiliates be identified.

SCGC also recommends that a quarterly report be provided by the applicants that identify all the discounts that have been provided.

The request by DRA and SCGC that the applicants provide a quarterly report about affiliate transactions, and OSD transactions in general, is not needed. As discussed above, the applicants are required to comply with sections III.B.2. and III.F. of the affiliate transaction rules. The affiliate discount report required by section III.F. will provide the same type of information that DRA and SCGC request be provided. In addition, under recent decisions of the Federal Energy Regulatory Commission (FERC), SoCalGas and SDG&E will be required to provide quarterly reports of off-system transportation services. (131 FERC Par. 61,150 (2010); 133 FERC Par. 61,216 (2010.)

3.3.3. Firm OSD

3.3.3.1. Position of the Applicants

For firm OSD service, the applicants propose to follow the same methodology the Commission approved in D.06-12-031 for allowing the applicants to provide firm OSD service to PG&E. That is, an open season will first be held to determine the interest in firm OSD service, and then a contract will be entered into. Afterwards, the applicants will file a separate application requesting approval of the contract for the facilities needed to provide firm OSD to a specific point. The Commission would then decide in that proceeding whether the facility additions are necessary, and whether the proposed firm OSD rate is just and reasonable.

In order to provide certainty to prospective firm shippers during the open season process, the applicants request that the Commission establish in this decision the general terms and conditions for firm OSD service, and the method for determining the firm OSD rate. According to the applicants, this will allow them to "meaningfully gauge market interest" during the open season for firm OSD services. (Ex. 2 at 3.)

To provide firm OSD service, the applicants note that facility upgrades or additional facilities will likely be needed so that gas can be physically delivered into the particular OSD point. As a result, the rate for firm OSD service is likely to differ from one receipt point to another. The applicants propose that the firm OSD rate be made up of a fixed contractual charge, plus an additional charge that is at least equal to the discountable, interruptible OSD rate. The purpose of the fixed contractual charge is to recover the full costs of any incremental facilities needed to provide the firm OSD service at a particular location. The applicants propose that this contractual charge include the cost of the facilities, plus any carrying costs and a return on equity. Any excess would be applied as a credit to existing customers' rates. According to the applicants, the second charge will ensure that existing ratepayers are not subsidizing the firm OSD service, and it will make an additional contribution to the cost of the existing system to benefit current on-system customers through reduced rates.

The applicants also request that they be allowed to roll the off-system facility costs of the firm OSD service into the overall transmission system costs if the applicants "can demonstrate that the incremental off-system facility costs are below the incremental revenues associated with charging the incremental firm off-system load the system average transmission rate." (Ex. 2 at 3.) The applicants note that this rolled-in treatment may be appropriate "in applications for new facilities that are relatively inexpensive or for older facilities that have been significantly depreciated and therefore have relatively low remaining net book value." (Ex. 2 at 3.)

Under the applicants' proposal, firm off-system customers will have priority over interruptible off-system customers at any given receipt point since the firm customers will have made a long term commitment to expand facilities in order to establish firm OSD service at that particular location.

3.3.3.2. Position of the Other Parties

DRA takes the position that it is premature to have the Commission establish in this decision the general terms and conditions for firm OSD service, and the rate structure for the firm OSD rate. DRA contends that firm OSD is a market driven service that will generate market-driven revenues. Since the firm OSD service is tied to the market, the rewards to ratepayers and the return on equity to shareholders should also be market driven. DRA contends that under the applicants' proposal, ratepayers may not receive any benefits if discounting is allowed to attract firm OSD shippers. In contrast, under the applicants' proposal, their shareholders earn a return on equity. DRA does not believe that the applicants should receive a guaranteed return on equity.

DRA also takes issue with the applicants' proposal to hold an open season for firm OSD service, and that a contract be negotiated based on the results of the open season. Under the applicants' proposal, DRA contends that the first opportunity of the Commission and the parties to review the results of the open season and the executed contract is when this information is presented in the application for firm OSD service. DRA believes this is too late in the process to allow for meaningful review and modifications, and there will be no motivation to ensure that ratepayers receive any benefit from the firm OSD service. DRA contends that the parties should have an opportunity to fully consider the cost implications and the associated operational changes that will be necessary before the applicants file an application with an executed contract requesting approval of the firm OSD service.

To allow for such a review, DRA recommends that the applicants describe their open season process and the results of the open season in a later phase of this proceeding or in a Tier 3 advice letter. This will allow DRA and other parties to review and comment on the results of the open season before any contract is entered into and any revenue sharing mechanism is adopted. Following this comment process, DRA proposes that the applicants file an application to offer this firm OSD service. DRA contends that its recommended process will make it more likely that the applicants will negotiate a deal that benefits both ratepayers and shareholders.

With regard to the applicants' proposal to roll-in the facility costs, SCGC and DRA recommend that the applicants demonstrate that the new facilities meet the FERC roll-in test instead of the applicants' roll-in proposal. SCGC proposes that if the new facilities meet the FERC roll-in test, that the rate for the firm OSD service be collected through a reservation charge instead of on a volumetric basis.

DRA also contends that the applicants need to address the development of a secondary market for the trading of any firm OSD capacity that a firm shipper might want to release on an intermittent basis since this additional OSD capacity will be competing with ratepayers for interruptible OSD revenues. DRA also contends that the applicants need to address the issue of residual rights, if any, of the firm shipper upon the expiration of its contract.

SCE agrees with the applicants' proposal that firm OSD customers be charged a volumetric charge that is subject to discount, as well as the fixed contractual charge that recovers the cost of building any firm off-system facilities.

The Indicated Producers and SCGC favor the two-part rate for firm OSD service. The Indicated Producers and SCGC are also opposed to any discounting of the firm OSD service. The Indicated Producers point out that such a restriction is warranted because under the applicants' proposal, their shareholders will receive a return on equity, which isolates shareholders from the impact of discounting. In contrast, if discounting is allowed, less revenue will be passed through to on-system customers to their detriment. To ensure that the utilities do not negotiate discounts that shift OSD costs to on-system users, the Indicated Producers recommend that the Commission restrict the applicants' ability to negotiate discounts to firm OSD service by imposing the two following conditions. First, the Indicated Producers recommend that the applicants be precluded from entering into transactions involving firm OSD service that do not cover the facility charges which are meant to recover the incremental capital costs associated with providing firm OSD service. Second, the Indicated Producers recommend that firm OSD users pay the full undiscounted interruptible OSD rate. SCGC recommends that if discounting is permitted, the discount should be limited to the OSD incremental facilities charge, and the applicants' shareholders should absorb the full impact of the discount.

3.3.3.3. Terms and Conditions of Firm OSD Service

The applicants and DRA propose two different approaches for how the terms and conditions for firm OSD service should be developed. The applicants propose that the preliminary terms and conditions be adopted in this decision, followed by the holding of an open season and the filing of an application and a contractual commitment by one or more shippers to use the firm OSD service. DRA's proposed process would have the applicants file the results of the open season in a proceeding or advice letter, followed by an opportunity for DRA and other parties to comment before any contract for firm OSD service is entered into and submitted through the application process.

DRA's proposed process should not be adopted because there is sufficient information before us to decide what the general terms and conditions should be for firm OSD service. DRA's proposed process would require the applicants to go through an additional comment and review process each time the applicants want to offer firm OSD service at a particular point. Instead of requiring the applicants to go through this comment and review process, it is more efficient for the Commission to adopt the general terms and conditions of firm OSD service in this decision so that the applicants and potential firm OSD shippers have an idea of how much this service will cost. Accordingly, DRA's proposal that the applicants propose the terms of an open season process through a comment and review process each time they seek to offer firm OSD service is not adopted. Instead, the applicants' process of holding an open season, entering into a contractual commitment with the prospective firm OSD shipper, and the filing of an application seeking approval of the new facilities and the rate to be charged for the firm OSD service, will be adopted using the terms and conditions described below.

The applicants and the other parties had ample opportunity in this proceeding to describe and comment on what the general terms and conditions for firm OSD service should be. For DRA and some of the other parties, they primarily disagree with the proposal that the applicants be allowed to earn a return on equity on the additional facilities that are needed to provide firm OSD service. DRA and the other parties disagree with that part of the applicants' proposal because there is no corresponding guarantee that on-system customers will receive any benefit from the firm OSD service. To offset the guarantee that the applicants' shareholders will earn a return on equity on the new facilities, the Indicated Producers and SCGC propose that the Commission prohibit any discounting of the volumetric part of the firm OSD rate. By prohibiting a discount of the volumetric charge, the Indicated Producers and SCGC believe that on-system customers will receive the benefit of rate reductions as a result of the offering of firm OSD service.

In weighing the competing interests of shareholder benefits, ratepayer benefits, and the applicants' process for the offering of firm OSD service, we adopt the following terms and conditions for the offering of firm OSD service.

First, the applicants shall include in the application for firm OSD service, a description of the open season process that was used. This will provide the parties with the information they need to help evaluate whether the open season process resulted in the best contract and price for the proposed firm OSD service.

Second, the firm OSD rate shall consist of the two charges that the applicants and the other parties agree should be included. The first charge shall be a reservation charge that shall collect all of the costs associated with the new facilities that are needed to offer firm OSD. The applicants will be permitted to earn a return on equity on these new facilities. The second charge shall be a volumetric charge that is equal to the base rate that is charged for interruptible OSD service.[8] The revenues derived from this second charge shall be credited for the benefit of on-system customers.

Third, to ensure that on-system customers receive a benefit from firm OSD, no discounting will be allowed of the firm OSD reservation charge or of the volumetric charge.

Fourth, the application for firm OSD service shall propose how the unused firm OSD capacity a firm shipper may want to release will be traded or sold. Furthermore, the application shall discuss the issue of residual rights, if any, that the firm shipper might have upon the expiration of the contract for firm OSD service.

Fifth, under appropriate circumstances, the applicants may propose in the application for firm OSD service that the firm OSD rate be rolled into the overall transmission system rate. However, today's decision does not adopt which test should be used for determining when it is appropriate to roll the firm OSD costs into the overall transportation rate. Instead, the applicants and the parties shall be permitted to propose in that new application what test should be used in determining whether a roll-in of the firm OSD costs should be permitted or not.

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[8] As discussed in section 3.3.2.2., the base rate for interruptible OSD service is 5 cents per Dth.

3.4. Hinshaw Exemption Issue

3.4.1. Introduction

One of the issues identified in the amended scoping memo was, "Will the applicants' Hinshaw exemptions be affected if the request to expand off-system deliveries to other interconnection points is granted." The applicants, SCE, and DRA briefed the Hinshaw exemption issue in their opening and reply briefs.

The Hinshaw exemption issue is an important jurisdictional issue because if the applicants' OSD service to interstate and international pipelines subjects them to the jurisdiction of the FERC, that will be detrimental to this Commission's regulation of the applicants' intrastate gas distribution activities.

SDG&E and SoCalGas contend that the authority they are requesting will not threaten this Commission's jurisdiction over the applicants' gas utility operations. The applicants assert that under existing FERC regulations and decisions, that OSD to markets outside California will not impact this Commission's regulation of their operations, and will not affect their Hinshaw exemption status under Section 1(c) of the Natural Gas Act. The applicants also point out that the authority they are seeking will place them on equal footing with PG&E, who can provide OSD at all of its backbone transportation paths including interstate pipelines.

The applicants point out that PG&E has the authority from the FERC under its blanket certificate to deliver gas from PG&E's intrastate transmission system to markets located outside of California. SDG&E and SoCalGas also hold these blanket certificates. The applicants contend that with this certificate, a Hinshaw pipeline or local distribution company is "authorized to engage in the sale or transportation of natural gas in interstate commerce without affecting the jurisdiction of state agencies under the Hinshaw exemption to the Natural Gas Act." (Applicants' Opening Brief at 19.)

The applicants also agree that they will terminate OSD service should the FERC or any court of competent jurisdiction find that such a service would adversely impact the Hinshaw exemption of either SDG&E or SoCalGas, and are agreeable to including such language into the OSD tariff.

SCE contends that the authority that the applicants request will not impact this Commission's ability to exercise jurisdiction over the gas utility operations of either SDG&E or SoCalGas. SCE contends that under the FERC decisions and regulations, that OSD by a Hinshaw pipeline, under the provisions of Part 284.224 of the FERC regulation, to a market outside of the state in which they are subject to state regulation will not impact the utility's status under the Hinshaw exemption in Section 1(c) of the Natural Gas Act.

DRA recommends that the Commission require that any OSD service be terminated if there is a potential that the applicants will lose their Hinshaw exemption status. DRA also recommends that the applicants demonstrate how this issue will be handled in any contracts for firm OSD service.

The applicants contend that the legal conclusions that were reached by each party about the impact of OSD service on the Hinshaw exemption issue were consistent and clear. The applicants contend that the proposed OSD services "will have no impact on the Commission's ability to exercise its jurisdiction under the Hinshaw exemption of the Natural Gas Act and applicable FERC precedent and regulation.

3.4.2. Discussion

The Natural Gas Act grants regulatory authority to the FERC over entities that engage in the sale of natural gas for resale or interstate gas transportation.

(See 15 USC §§ 717-717z.) The Hinshaw exemption, which is found in Section 717(c) of Title 15 of the United States Code, exempts such entities from FERC's jurisdiction if that entity receives all of its out-of-state gas within or at the boundary of that state, and if all the natural gas that it receives is consumed within that state. The federal appellate courts have recognized that this provision creates an exception from the FERC's jurisdiction over an entity's rates, services, and facilities within the state where the gas is consumed. (Altamont Gas Transmission Company v. FERC , 92 F.3d 1239, 1243; (D.C. Cir. 1996); Public Utilities Commission of the State of California v. FERC, 143 F.3d 610, 614-615, (D.C. Cir. 1998).)

Both SDG&E and SoCalGas are exempt from FERC's jurisdiction under the Hinshaw exemption, and are considered "Hinshaw pipelines" as defined in Section 284.224(h)(1) of FERC's regulations.[9] SDG&E and SoCalGas also hold Part 284 blanket transportation certificates that were issued by the FERC. (See 41 FERC Par. 61,173 (1987), 64 FERC Par. 61,221 (1993).) With a blanket certificate, the FERC regulations allow the blanket certificate holder to engage in the transportation of natural gas on behalf of an interstate pipeline or a local distribution company served by an interstate pipeline, or the sale of natural gas to an interstate pipeline or to a local distribution company served by an interstate pipeline, without impairing its Hinshaw exemption. This transportation or sale by the blanket certificate holder will not subject the holder to FERC jurisdiction

[9] This section is found in 18 Code of Federal Regulations § 284.224(h)(1), which defines a "Hinshaw pipeline" to mean "any person engaged in the transportation of natural gas which is not subject to the jurisdiction of the [FERC] under the Natural Gas Act solely by reason of section 1(c) of the Natural Gas Act."

except to the extent necessary to enforce the terms and conditions of the blanket certificate. (18 CFR § 284.224(d); See 18 CFR §§ 284.122, 284.142.)[10]

In support of their position, the applicants and SCE cite to two FERC decisions. The first decision addressed a situation in which PG&E was issued a limited jurisdiction blanket transportation certificate. The second decision involved an entity that had filed for a limited jurisdiction blanket certificate with the FERC, while a parallel proceeding addressing the jurisdictional status of that entity's transportation service was pending. (See 69 FERC Par. 61,140 at 61,505–61,506 (1994), 70 FERC Par. 61,121 at 61,327 (1995).) In both situations, the FERC agreed that these entities could provide off-system transportation services without affecting their Hinshaw exemptions. In its order granting a limited blanket certificate to PG&E, the FERC specifically rejected the argument that such off-system transportation would jeopardize PG&E's Hinshaw exemption. In rejecting this argument, the FERC recognized that PG&E was not relying on its Hinshaw exemption status to engage in the OSD. Instead, PG&E was seeking a limited jurisdiction blanket certificate which permits the entity to "engage in the activities contemplated in section 1(c) [of 15 USC § 717] --- while at the same time participating in the restricted types of jurisdictional transactions specified in section 284.224 of the Commission's regulations --- and retain its NGA-exempt Hinshaw status." (69 FERC Par. 61,140 at 61,504.)

We have reviewed the applicable FERC regulations and decisions and agree with the applicants and SCE that authorizing the expansion of interruptible and

[10] In contrast, a Hinshaw pipeline that does not have a blanket certificate is not authorized to sell or transport natural gas in interstate commerce as an intrastate pipeline. (18 CFR § 284.224(g).)

firm OSD service to other interconnections will not impact the Hinshaw exemptions of SDG&E and SoCalGas, or the ability of this Commission to regulate their activities. However, should the FERC or any court of competent jurisdiction issue a decision or a preliminary determination that the OSD service adversely impacts the Hinshaw exemption of either SDG&E or SoCalGas, we will require SoCalGas and SDG&E to take steps to immediately terminate all OSD services. The applicants have expressed their willingness to abide by such a condition, and they shall be required to include such a condition in their OSD tariffs and in their contracts for OSD service.

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 the applicants, DRA, Indicated Producers, SCE, and SCGC. Reply comments were filed by the applicants, Indicated Producers, and SCE. Those comments have been reviewed, and appropriate changes have been incorporated into this 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. SDG&E and SoCalGas were authorized in D.06-12-031 to make OSD to PG&E at a rate of 5 cents per Dth for interruptible service, and to hold an open season to solicit interest in firm OSD to PG&E's system and to file an application for that firm service.

2. The applicants request that they be allowed to make OSD of gas to all pipeline interconnections on an interruptible basis, and that the offering of firm OSD service follow the process approved in D.06-12-031.

3. Interruptible OSD service is usually accomplished by the displacement of the gas supply that is normally received at the OSD interconnection point, or from another receipt point or gas storage on the applicants' transmission systems.

4. Firm OSD service is accomplished by the physical redelivery of gas supply from the applicants' transmission systems to the OSD point.

5. Allowing the applicants to offer OSD service to all of its pipeline interconnections will provide the applicants with the flexibility to readily respond to gas demand needs in east of California markets, give the applicants the same kind of authority that PG&E currently has, and increase the utilization of the applicants' transmission facilities.

6. Since the firm and interruptible OSD services are to be second in priority to all on-system demand and services, there will be no operational impact on the on-system customers, or on the applicants' ability to have available supplies of gas to meet their on-system customers' needs and services, or on the applicants' transmission facilities.

7. Since interruptible OSD service uses the displacement of flowing supplies, SoCalGas will incur negligible operational costs to provide this service.

8. D.06-12-031 rejected the argument that OSD services should be delayed because of possible impacts on gas storage.

9. The interruptible OSD rate is not tied to the level of the FAR charge.

10. Discounting of the interruptible OSD rate is to be done on a non-discriminatory basis.

11. Allowing the discounting of the interruptible OSD rate will encourage potential OSD shippers to use this service, which in turn will maximize the use of the transmission system.

12. The operating conditions on SoCalGas' Southern System requires that a certain minimum amount of gas flow through that part of the system in order to serve customers located in certain counties.

13. A gas imbalance could occur following the Cycle 4 gas nomination process due to a mismatch in the amount of gas coming from an interconnecting pipeline.

14. One of the benefits of expanding OSD service is that the applicants propose to use the incremental revenues to offset transmission costs for on-system customers.

15. Affiliate transaction rule III.F. requires that if a "discount, rebate, or other waiver of any charge or fee" is provided to an affiliate, then an affiliate discount report must be filed.

16. Affiliate transaction rule III.B.2. requires that if a discount is offered to the utility's affiliate, the utility is to contemporaneously make such discount or waiver available to all similarly situated market participants.

17. The request by DRA and SCGC that the applicants provide a quarterly report about their affiliate transactions is not needed because the affiliate discount report required by III.F. of the affiliate transaction rules will provide that same type of information.

18. The applicants and DRA propose two different approaches for how the terms and conditions for firm OSD service should be developed.

19. It is more efficient for the Commission to adopt the general terms and conditions of firm OSD service in this decision so that the applicants and potential firm OSD shippers have an idea of how much this service will cost.

20. SDG&E and SoCalGas are exempt from FERC's jurisdiction under the Hinshaw exemption and are considered Hinshaw pipelines, and hold Part 284 blanket transportation certificates issued by the FERC.

Conclusions of Law

1. SCGC's request to deny the applicants' application is denied.
2. The applicants' request to eliminate the reference in SoCalGas' Rule No. 23 to SoCalGas' Schedule No. GIT, and to eliminate Schedule No. GIT is granted.
3. The applicants should be allowed to expand their interruptible OSD service to all of their interconnection points with interstate and international receipt points on the terms and conditions described in sections 3.3.2. and 3.4. of this decision.
4. The offering of interruptible OSD by the applicants shall not result in any increased costs being passed on to on-system customers.
5. SoCalGas shall revise its tariff to require that if system integrity cannot be maintained with the nominated level of interruptible OSD service, or if the level of nominations exceeds the capacity of the transmission line, the applicants shall be required to curtail or reduce the interruptible OSD nominations.
6. The applicants shall be required to define in their interruptible OSD service tariff that a "similarly situated" shipper means those shippers using a given receipt point on a given day, and to post on a daily basis all interruptible OSD discounts and to offer the same discount to other similarly situated shippers using such service.
7. A floor rate for interruptible OSD service shall be established to ensure that the interruptible OSD rate is not lower than the cost of providing such service and those existing on-system customers are not subsidizing OSD services.

8. The base rate for interruptible OSD service shall be set at 5 cents per Dth, allowed to be increased to a maximum of 15 cents per Dth, and allowed to be discounted down to as low as 1.5 cents per Dth.

9. Interruptible and firm OSD service on SoCalGas' Southern System is to be curtailed if it creates or worsens a minimum flow condition or it imposes other operational costs to on-system customers.

10. To prevent on-system customers from having to pay for gas purchases to maintain system integrity on the Southern System as a result of interruptible or firm OSD, SoCalGas shall reflect in its tariff that the revenues from OSD from the Southern System first go to pay for the fixed deliveries for the day to offset the SRMA costs, and any excess revenues above the day's SRMA costs then be credited to the ITBA for sharing purposes.

11. For interruptible and firm OSD, all OSD shippers shall be required to resolve their imbalances within three business days, and if the imbalance is not resolved within that time period, then the imbalance is to be resolved in accordance with the terms of SoCalGas' Schedule G-IMB tariff.

12. SoCalGas shall revise its Schedule G-RPA tariff so that a G-RPA customer will be required to nominate to a pool account or storage account before the customer can nominate to an OSD account.

13. The applicants' proposal to allocate the net savings from the interruptible OSD service to on-system customers shall be adopted.

14. Any discounting of the interruptible OSD rate shall comply with III.F. and III.B.2. of the affiliate transaction rules.

15. The applicants' process of holding an open season, entering into a contractual commitment with a prospective firm OSD shipper, and filing an application to seek approval of the new facilities and the rate to be charged for

firm OSD service, shall be adopted using the terms and conditions of firm OSD service as described in this decision.

16. The applicants should be allowed to expand their firm OSD service to all of their interconnection points with interstate and international receipt points on the terms and conditions described in sections 3.3.3. and 3.4. of this decision.

17. The offering of firm OSD service shall comply with the five following terms and conditions described in section 3.3.3.3. of this decision: first, the application for firm OSD service shall provide a description of the open season process; second, the firm OSD rate shall consist of the two charges described in this decision; third, to ensure that on-system customers receive a benefit from firm OSD service, no discounting will be allowed; fourth, the application for firm OSD service shall address how any unused firm OSD capacity a firm shipper may want to release will be traded or sold, and discuss the residual rights, if any, that the firm shipper might have upon the expiration of the contract for firm OSD service; and fifth, under appropriate circumstances, the applicants may propose in the application for firm OSD service that the firm OSD rate be rolled into the overall transmission system rate, but the test for determining whether a roll-in should be permitted is to be addressed in that new proceeding.

18. Under the FERC regulations, a blanket certificate holder is allowed to engage in the transportation of natural gas on behalf of an interstate pipeline or a local distribution company served by an interstate pipeline, or the sale of natural gas to an interstate pipeline or to a local distribution company served by an interstate pipeline, without impairing its Hinshaw exemption.

19. Authorizing the expansion of interruptible and firm OSD service to other interconnections will not impact the Hinshaw exemptions of SDG&E and SoCalGas, or the ability of this Commission to regulate their activities.

20. Should the FERC or any court of competent jurisdiction issue a decision or a preliminary determination that the OSD service adversely impacts the Hinshaw exemption of either SDG&E or SoCalGas, SDG&E and SoCalGas should be required to take steps to immediately terminate all OSD services, and to reflect that condition in their tariffs and contracts for OSD services.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company (SDG&E) and Southern California Gas Company (SoCalGas) are authorized to expand their interruptible off-system delivery (OSD) service to all of their other interconnection points with interstate and international receipt points on the terms and conditions described more fully in section 3.3.2. of this decision and summarized as follows: first, the offering of interruptible OSD shall not result in any adverse operational impacts to on-system customers; second, the base rate for interruptible OSD service is 5 cents per decatherm (Dth), and can range up to the rate cap of 15 cents per Dth, and can be discounted on a non-discriminatory basis to as low as 1.5 cents per Dth; third, the OSD tariff shall reflect that the revenues from OSD from the Southern System first go to pay for the fixed deliveries for the day to offset the System Reliability Memorandum Account (SRMA) costs, and any revenues over and above the day's SRMA costs then be credited to the Interstate Transportation Balancing Account for sharing purposes; fourth, all OSD shippers shall resolve their imbalances within three business days, and if not, the imbalance is to be resolved in accordance with the terms of SoCalGas' Schedule G-IMB; fifth, SoCalGas' Schedule G-RPA shall be revised; sixth, the net savings from the interruptible OSD service is to be allocated to on-system customers; and seventh, any discounting of

the OSD charge is to comply with sections III.B.2. and III.F. of the affiliate transaction rules.

2. San Diego Gas & Electric Company and Southern California Gas Company are authorized to expand their firm off-system delivery (OSD) service to all of their other interconnection points with interstate and international receipt points on the terms and conditions described more fully in sections 3.3.2. and 3.3.3. of this decision and summarized as follows: first, the OSD tariff shall reflect that the revenues from OSD from the Southern System first go to pay for the fixed deliveries for the day to offset the System Reliability Memorandum Account (SRMA) costs, and any revenues over and above the day's SRMA costs then be credited to the Interstate Transportation Balancing Account for sharing purposes; second, all OSD shippers shall resolve their imbalances within three business days, and if not, the imbalance is to be resolved in accordance with the terms of SoCalGas' Schedule G-IMB; third, the application for firm OSD service shall provide a description of the open season process; fourth, the firm OSD rate shall consist of the two charges described in this decision; fifth, no discounting will be allowed; sixth, the application for firm OSD service shall address how any unused firm OSD capacity a firm shipper may want to release will be traded or sold, and discuss the residual rights, if any, that the firm shipper might have upon the expiration of the contract for firm OSD service; and seventh, under appropriate circumstances, the applicants may propose in the application for firm OSD service that the firm OSD rate be rolled into the overall transmission system rate, but the test for determining whether a roll-in should be permitted is to be addressed in that new proceeding.

3. San Diego Gas & Electric Company and Southern California Gas Company are authorized to file appropriate Tier 1 advice letters for the offering of

interruptible off-system delivery services, and firm off-system delivery services, and which reflect the terms and conditions of such services as described and set forth in sections 3.3. and 3.4. and Ordering Paragraphs 1 and 2 of this decision.

4. Should the Federal Energy Regulatory Commission or any court of competent jurisdiction issue a decision or a preliminary determination that the off-system delivery (OSD) service adversely impacts the Hinshaw exemption of either San Diego Gas & Electric Company (SDG&E) or Southern California Gas Company (SoCalGas), SDG&E and SoCalGas shall take steps immediately to terminate all OSD services. SDG&E and SoCalGas shall reflect this condition in their tariffs and contracts for off-system delivery services.

This proceeding is closed.

Dated ____________________________, at San Francisco, California.

APPENDIX A

************** SERVICE LIST *************
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************** **PARTIES** **************

Evelyn Kahl
ALCANTAR & KAHL, LLP
33 NEW MONTGOMERY STREET, SUITE 1850
SAN FRANCISCO CA 94015
(415) 421-4143
ek@a-klaw.com
For: Indicated Producers

Edward G. Poole
ANDERSON & POOLE
601 CALIFORNIA STREET, SUITE 1300
SAN FRANCISCO CA 94108-2812
(415) 956-6413 X-102
epoole@adplaw.com
For: California Independent Petroleum Association

Daniel W. Douglass
DOUGLASS & LIDDELL
EMAIL ONLY
EMAIL ONLY CA 00000
(818) 961-3001
douglass@energyattorney.com
For: Transwestern Pipeline Company

Stephen G. Koerner
CRAIG RICHARDSON
EL PASO CORPORATION - WESTERN PIPELINES
2 NORTH NEVADA AVE.
COLORADO SPRINGS CO 80903
(719) 520-4443
steve.koerner@elpaso.com
For: El Paso Corporation

Mark A. Minich
Senior Counsel
EL PASO CORPORATION-WESTERN PIPELINES
2 N. NEVADA AVENUE
COLORADO SPRINGS CO 80903
(719) 520-4416
mark.minich@elpaso.com
For: El Paso Corporation-Western Pipelines

Jeanne B. Armstrong
GOODIN MACBRIDE SQUERI DAY & LAMPREY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111
(415) 392-7900
jarmstrong@goodinmacbride.com
For: Questar Southern Trails Pipeline Company

Michael B. Day
GOODIN MACBRIDE SQUERI DAY & LAMPREY LLP
505 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94111-3133
(415) 392-7900
mday@goodinmacbride.com
For: Kern River Pipeline Company

Norman A. Pedersen
Attorney
HANNA AND MORTON LLP
444 SOUTH FLOWER ST. SUITE 1500
LOS ANGELES CA 90071-2916
(213) 430-2510
npedersen@hanmor.com
For: Southern California Generation Coalition

Joel L. Greene
JENNINGS, STROUSS & SALMON, PLC
1350 I STREET, N.W., STE. 810
WASHINGTON DC 20005-3305
(202) 371-9889
jgreene@jsslaw.com
For: Salt River Project Agricultural Improvement and Power District

---

William H. Booth
LAW OFFICES OF WILLIAM H. BOOTH
67 CARR DRIVE
MORAGA CA 94556
(925) 376-7370
wbooth@booth-law.com
For: Woodside Natural Gas, Inc.

Greggory L. Wheatland
ELLISON SCHNEIDER & HARRIS L.L.P.
2600 CAPITOL AVENUE, SUITE 400
SACRAMENTO CA 95816-5905
(916) 447-2166
glw@eslawfirm.com
For: Clearwater Port LLC

Diana L. Lee
Legal Division
RM. 4107
505 Van Ness Avenue
San Francisco CA 94102 3298
(415) 703-4342
dil@cpuc.ca.gov
For: Division of Ratepayer Advocates

John Ellis
SDG&E AND SOCALGAS
555 WEST FIFTH STREET, SUITE 1400
LOS ANGELES CA 90013-1034
(213) 244-2978
JEllis@SempraUtilities.com
For: Southern California Gas Company / San Diego Gas & Electric Company

---

William D. Rapp
Attorney At Law
SEMPRA LNG
101 ASH STREET, HQ-12
SAN DIEGO CA 92101
(619) 699-5050
WRapp@Sempraglobal.com
For: Sempra LNG

Kavita P. Lesser
SOUTH COAST AIR QUALITY MANAGEMENT DISTR
21865 COPLEY DRIVE
DIAMOND BAR CA 91765-0940
(909) 396-3460
klesser@aqmd.gov
For: South Coast Air Quality Management District

Douglas K. Porter
Attorney At Law
SOUTHERN CALIFORNIA EDISON COMPANY
2244 WALNUT GROVE AVENUE
ROSEMEAD CA 91770
(626) 302-3964
douglas.porter@sce.com
For: Southern California Edison

John W. Leslie, Esq.
LUCE, FORWARD, HAMILTON & SCRIPPS, LLP
EMAIL ONLY
EMAIL ONLY CA 00000
(619) 699-2536
jleslie@luce.com
For: Shell Energy North America (US), L.P.

********** **STATE EMPLOYEE** ***********

Joyce Alfton
Energy Division
AREA 4-A
505 Van Ness Avenue
San Francisco CA 94102 3298
(415) 703-2616
alf@cpuc.ca.gov

Richard A. Myers
Energy Division
AREA 4-A
505 Van Ness Avenue
San Francisco CA 94102 3298
(415) 703-1228
ram@cpuc.ca.gov

Paul S. Phillips
Executive Division
RM. 5212
505 Van Ness Avenue
San Francisco CA 94102 3298
(415) 703-1786
psp@cpuc.ca.gov

John S. Wong
Administrative Law Judge Division
RM. 5106
505 Van Ness Avenue
San Francisco CA 94102 3298
(415) 703-3130
jsw@cpuc.ca.gov

********* **INFORMATION ONLY** **********

Karen Terranova
ALCANTAR & KAHL
33 NEW MONTGOMERY STREET, SUITE 1850
SAN FRANCISCO CA 94105
(415) 421-4143
filings@a-klaw.com

Marcel Hawiger
THE UTILITY REFORM NETWORK
115 SANSOME STREET, SUITE 900
SAN FRANCISCO CA 94104
(415) 929-8876 X302
marcel@turn.org
For: The Utility Reform Network

Seema Srinivasan
ALCANTAR & KAHL LLP
33 NEW MONTGOMERY STREET, SUITE 1850
SAN FRANCISCO CA 94015
(415) 421-4143
sls@a-klaw.com
For: Indicated Producers

Mike Cade
ALCANTAR & KAHL, LLP
1300 SW 5TH AVE, SUITE 1750
PORTLAND OR 97201
(503) 402-8711
wmc@a-klaw.com

Norm Spooner
ARIZONA PUBLIC SERVICE
410 N. 5TH ST.
PHOENIX AZ 85004
(602) 250-4309
norman.spooner@aps.com

Kenneth Nordlander
ARIZONA PUBLIC SERVICE COMPANY
400 N 5TH ST. MS 8974
PHOENIX AZ 85004
(602) 250-3658
kenneth.nordlander@aps.com

Catherine E. Yap
BARKOVICH & YAP, INC.
PO BOX 11031
OAKLAND CA 94611
(510) 450-1270
ceyap@earthlink.net

Bruno Jeider
BURBANK WATER AND POWER
164 WEST MAGNOLIA BOULEVARD
BURBANK CA 91502
(818) 238-3700
bjeider@ci.burbank.ca.us

Hilary Corrigan
CALIFORNIA ENERGY MARKETS
425 DIVISADERO ST. SUITE 303
SAN FRANCISCO CA 94117-2242
(415) 963-4439
cem@newsdata.com

Annie Stange
ALCANTAR & KAHL LLP
1300 SW FIFTH AVENUE, SUITE 1750
PORTLAND OR 97201
(503) 402-8703
sas@a-klaw.com

George Dehart
CITY OF ANAHEIM
200 SOUTH ANAHEIM BOULEVARD
ANAHEIM CA 92805
(714) 765-4257
gdehart@anaheim.net

Steven Sciortino
CITY OF ANAHEIM
200 SOUTH ANAHEIM BOULEVARD
ANAHEIM CA 92805
(714) 765-5177
ssciortino@anaheim.net

Ren Zhang
CITY OF PASADENA WATER AND POWER
150 S. LOS ROBLES AVENUE, SUITE 200
PASADENA CA 91101
(626) 744-7904
rzhang@cityofpasadena.net

Steve Endo
Attn: Steve Endo
CITY OF PASADENA WATER AND POWER
150 S. LOS ROBLES AVENUE, SUITE 200
PASADENA CA 91101
(626) 744-6246
sendo@ci.pasadena.ca.us

Donald C. Liddell
DOUGLASS & LIDDELL
EMAIL ONLY
EMAIL ONLY CA 00000
(619) 993-9096
liddell@energyattorney.com

Gregory S.G. Klatt
DOUGLASS & LIDDELL
EMAIL ONLY
EMAIL ONLY CA 00000
(818) 961-3002
klatt@energyattorney.com

W. Wayne Tomlinson
EL PASO CORPORATION- WESTERN PIPELINES
2 NORTH NEVADA AVE.
COLORADO SPRINGS CO 80903
(719) 520-4579
william.tomlinson@elpaso.com

W. Wayne Tomlinson
EL PASO CORPORATION- WESTERN PIPELINES
2 NORTH NEVADA AVENUE
COLORADO SPRINGS CO 80903
(719) 520-4579
william.tomlinson@elpaso.com

Jeffery D. Harris
ELLISON, SCHNEIDER & HARRIS LLP
2600 CAPITOL AVENUE, SUITE 400
SACRAMENTO CA 95816-5905
(916) 447-2166
jdh@eslawfirm.com

Steven G. Lins
Assistant General Manager Supply
GLENDALE WATER AND POWER
141 N. GLENDALE AVENUE, LEVEL 4
GLENDALE CA 91206-4394
(818) 548-2136
slins@ci.glendale.ca.us

Scott A. Lehecka
Attorney At Law
HANNA AND MORTON LLP
444 S. FLOWER STREET, 15TH FLOOR
LOS ANGELES CA 90071
(213) 430-2508
slehecka@hanmor.com

Sylvia Cantos
HANNA AND MORTON LLP
444 SOUTH FLOWER STREET, SUITE 1500
LOS ANGELES CA 90071-2916
scantos@hanmor.com

Alana Steele
Attorney At Law
HANNA AND MORTON, LLP
444 SOUTH FLOWER STREET, SUITE 1500
LOS ANGELES CA 90071-2916
(213) 430-2502

Jeffrey M. Garber
General Counsel
IMPERIAL IRRIGATION DISTRICT
333 EAST BARIONI BOULEVARD
IMPERIAL CA 92251
(760) 339-9574
jmgarber@iid.com

For: El Paso Corporation
Michael E. Campbell
Interim General Manager
IMPERIAL IRRIGATION DISTRICT
333 EAST BARIONI BOULEVARD
IMPERIAL CA 92251
(760) 339-9224
mecampbell@iid.com

Kirby Bosley
JP MORGAN VENTURES ENERGY CORP.
700 LOUISIANA ST. STE 1000, 10TH FLR
HOUSTON TX 77002
(713) 236-3383
kirby.bosley@jpmorgan.com

Laurie K. Brown
Proj. Mgr., Bus. Development
KERN RIVER GAS TRANSMISSION COMPANY
2755 E. COTTONWOOD PARKWAY, STE. 300
SALT LAKE CITY UT 84121
(801) 937-6410
laurie.brown@kernrivergas.com

Robert L. Pettinato
L.A. DEPT. OF POWER & WATER-NAT. GAS GRP
111 NORTH HOPE STREET, ROOM 1150
LOS ANGELES CA 90012-0100
(213) 367-1735
robert.pettinato@ladwp.com

Richard J. Morillo
PO BOX 6459
BURBANK CA 91510-6459
(818) 238-5702
rmorillo@ci.burbank.ca.us

MRW & ASSOCIATES, LLC
EMAIL ONLY
EMAIL ONLY CA 00000
(510) 834-1999
mrw@mrwassoc.com

Diane I. Fellman
NRG WEST
73 DOWNEY STREET
SAN FRANCISCO CA 94117
(415) 665-3824
Diane.Fellman@nrgenergy.com

Chrisopher A. Hilen
NV ENERGY
6100 NEIL ROAD
RENO NV 89511
(775) 834-5696
chilen@NVEnergy.com
For: NV Energy

Taryn Ciardella
Sr. Legal Secretary
NV ENERGY
EMAIL ONLY
EMAIL ONLY NV 00000
(775) 834-4347
tciardella@nvenergy.com

Eric Klinkner
PASADENA DEPARTMENT OF WATER AND POWER
150 SOUTH LOS ROBLES AVENUE, SUITE 200
PASADENA CA 91101-2437
(626) 744-4478
eklinkner@cityofpasadena.net

Lori-Lynn Pennock
Sr. Fuel Supply Analyst
MAIL STATION POBOO1
6504 E. THOMAS ROAD
SCOTTSDALE AZ 85251
(602) 236-4360
Lori-Lynn.Pennock@srpnet.com
For: Salt River Project Agricultural Improvement and Power District

L. Bradley Burton
Mgr - Fed Reg Affairs
QUESTAR PIPELINE CO.
180 EAST 100 SOUTH / PO BOX 45360
SALT LAKE CITY UT 84145-0360
(801) 324-2459
Brad.Burton@questar.com

David S. Andersen
Sr. Corp Counsel
QUESTAR PIPELINE COMPANY
180 EAST 100 SOUTH, PO BOX 45360
SALT LAKE CITY UT 84145-0360
(801) 324-5697
dave.andersen@questar.com

Gaylen S. Haag
QUESTAR PIPELINE COMPANY
180 EAST 100 SOUTH, PO BOX 45360
SALT LAKE CITY UT 84145-0360
(801) 324-5133
gaylen.haag@questar.com

Robert R. Taylor
SALT RIVER PROJECT
PO BOX 52025, PAB 221
PHOENIX AZ 85072
(602) 236-3487
Rob.taylor@srpnet.com
For: Salt River Project

William Tobin
SEMPRA GLOBAL
101 ASH STREET, HQ08C
SAN DIEGO CA 92101
(619) 696-4868
WTobin@SempraGlobal.com

Marcie A. Milner
SHELL ENERGY NORTH AMERICA (US), L.P.
4445 EASTGATE MALL, STE. 100
SAN DIEGO CA 92121
(858) 526-2106
marcie.milner@shell.com

Kurt R. Wiese
Attorney At Law
SOUTH COAST AIR QUALITY MANAGEMENT DISTR
21865 COPELY DRIVE
DIAMOND BAR CA 91765
(909) 396-3460
kwiese@aqmd.gov
For: SOUTH COAST AIR QUALITY MANAGEMENT DISTRICT

Michael S. Alexander
Energy Supplly And Management
SOUTHERN CALIFORNIA EDISON
2244 WALNUT GROVE AVE
ROSEMEAD CA 91006
(626) 302-2029
michael.alexander@sce.com

Case Administration
SOUTHERN CALIFORNIA EDISON COMPANY
LAW DEPARTMENT, ROOM 370
2244 WALNUT GROVE AVENUE, ROOM 370
ROSEMEAD CA 91770
(626) 302-4875
case.admin@sce.com

Tristan Reyes Close
SOUTHERN CALIFORNIA EDISON COMPANY
2244 WALNUT GROVE AVENUE
ROSEMEAD CA 91770
(626) 302-2883
tristan.reyesclose@sce.com

David J. Gilmore
SOUTHERN CALIFORNIA GAS COMPANY
555 WEST FIFTH STREET, GT-14E7
LOS ANGELES CA 90013
(213) 244-2945
DGilmore@SempraUtilities.com

Jeffrey L. Salazar
SOUTHERN CALIFORNIA GAS COMPANY
555 WEST FIFTH STREET, GT14D6
LOS ANGELES CA 90013
(213) 244-5916
JLSalazar@SempraUtilities.com

Kari Kloberdanz
SOUTHERN CALIFORNIA GAS COMPANY
555 WEST 5TH STREET, GT14D6
LOS ANGELES CA 90013-1011
(213) 244-3807
KKloberdanz@SempraUtilities.com
For: Southern California Gas Company

Kelly A. Daly
STINSON MORRISON HECKER LLP
1150 18TH ST., SUITE 800 N.W.
WASHINGTON DC 20036
(202) 785-9100
kdaly@stinson.com
For: Arizona Public Service Company

Shelley A. Corman
Sr. Vice-President
TRANSWESTERN PIPELINE COMPANY, LLC
711 LOUISIANA STREET, SUITE 900
HOUSTON TX 77002
(281) 714-2051
shelley.corman@energytransfer.com

Shemeika S. Landry
Senior Counsel
TRANSWESTERN PIPELINE COMPANY, LLC
711 LOUISIANA STREET, SUITE 900
HOUSTON TX 77002
(281) 714-2051
shemeika.landry@energytransfer.com

Hans Laetz, J.D.
ZUMA IMPACT LLC
6402 SURFSIDE WAY
MALIBU CA 90265
(310) 579-5085
hanslaetz@gmail.com

(END OF APPENDIX A)