Decision ________________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Gas Company in Compliance with Resolution G-3304 and of Southern California Gas Company (U 904 G) and San Diego Gas & Electric Company (U 902 G) to Consolidate their Gas Supply Portfolios.	Application 01-01-021 (Filed January 11, 2001)

(Appearances are in Attachment A)

OPINION AUTHORIZING CONSOLIDATED GAS SUPPLY PORTFOLIOS AND GAS ACQUISITION MANAGEMENT

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OPINION AUTHORIZING CONSOLIDATED GAS SUPPLY PORTFOLIOS AND GAS ACQUISITION MANAGEMENT

Summary

To promote efficiency and reduce costs, we authorize Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) to:

1. consolidate their gas supply portfolios and related interstate pipeline and storage capacities, and to charge the same cost of gas to utility procurement customers in the SoCalGas and SDG&E service territories;
2. consolidate the management of their separate gas acquisition functions into a single management group;
3. implement revised uniform rules for their noncore customers wishing to obtain core service from them;
4. implement revised uniform rules for large core customers who wish to obtain utility procurement service;
5. allow non-affiliated wholesale customers to purchase gas from their combined portfolio;
6. provide that when brokering arrangements elapse for unassigned SoCalGas capacity on the El Paso Natural Gas Company's pipeline that capacity will be reallocated to the two utilities' consolidated gas supply portfolio; and

Background

On December 11, 2000, SoCalGas filed Advice Letters (AL) 2978 and 2979. At that time the market price of gas delivered at the California border had reached an unprecedentedly high level, both in absolute terms and relative to the market price of gas in producing basins plus the as-billed rate for firm interstate transportation. SoCalGas' average cost of gas had become very attractive compared to alternative supplies available in the marketplace.

In AL 2978, SoCalGas requested that the Commission apply a new formula for determining its monthly procurement rate for noncore customers selecting core subscription service beginning January 1, 2001. In AL 2979, SoCalGas requested that the same formula apply to its noncore customers who requested to transfer to bundled core service after December 1, 2000 (including gas procurement service).

In Resolution G-3304, issued December 21, 2000, the Commission found that if noncore (including wholesale) customers of SoCalGas were allowed to elect core subscription or traditional core service (including procurement service), it would substantially increase SoCalGas' cost of gas for its existing core and core subscription customers. Moreover, the Commission found that SoCalGas' proposal to create a class of procurement service that would be charged an incremental procurement cost was too complicated and speculative to adopt on an emergency basis. Instead, the Commission ordered SoCalGas to suspend transfers of noncore customers (including wholesale customers) to core subscription or traditional core service, except for customers whose gas supply provider was no longer offering service in California if SoCalGas was convinced that such customers would be left without service. Resolution G-3304 also required SoCalGas to file an application to address the issues contained in its advice letters.

On January 11, 2001, SoCalGas and SDG&E jointly filed this application. In addressing the issues required by Resolution G-3304, they propose new rules for eligibility and conditions for core service, the consolidation of the management of SoCalGas and SDG&E's currently separate gas acquisition departments, and the consolidation of the two utilities' gas supply portfolios, including associated storage and interstate capacity.

SoCalGas and SDG&E propose to:

1. Consolidate their gas supply portfolios and related interstate pipeline and storage capacities, and to charge the same cost of gas to utility procurement customers in the SoCalGas and SDG&E service territories.
2. Consolidate the management of their currently separate gas acquisition functions into a single management group, to lower total overhead expenses and promote more efficient gas purchasing.
3. Implement revised uniform rules for their noncore customers wishing to obtain gas supply (or procurement) service from them.
4. Implement revised uniform rules for large core customers who wish to obtain utility procurement service after having first elected transportation-only service.
5. Allow non-affiliated wholesale customers to purchase gas from the combined portfolio on terms that are reasonable for all affected core gas consumers.
6. Provide that when brokering arrangements elapse for unassigned SoCalGas capacity on the El Paso Natural Gas Company's pipeline (in excess of that which the Commission allocated to the SoCalGas core market in the last Biannual Cost Allocation Proceeding (BCAP)), that capacity should be allocated to the consolidated gas supply portfolio.
7. Allow employees in the consolidated gas procurement function to participate in the negotiation of any power contracts and associated gas supply arrangements by SDG&E that involve "tolling" provisions.

Public hearings were held June 25 and 26, 2001, before Administrative Law Judge (ALJ) Robert Barnett. The matter was submitted subject to the filing of briefs. Briefs were filed by applicants, Office of Ratepayer Advocates (ORA), The

Utility Reform Network (TURN), Southern California Generation Coalition (SCGC), the city of Long Beach, El Segundo Power and Long Beach Generation (ES/LB), and the California Industrial Group and the California Manufacturers & Technology Association (CIG/CMTA).

1. Consolidation of the SoCalGas and SDG&E Gas Acquisition Portfolios

SoCalGas and SDG&E propose to consolidate their gas commodity procurement and management functions into a combined gas portfolio which would be managed by a single organization. They request management discretion to determine whether the personnel would be employees of SoCalGas or SDG&E, or some combination thereof. The combined gas acquisition organization would remain separate from the utilities' gas operations organization, as required by SoCalGas/SDG&E merger conditions.[1] They propose that the cost of all gas supplies and associated storage and interstate capacity currently held by SoCalGas and SDG&E and all new supplies and assets be included in the combined portfolio. Currently unassigned El Paso capacity held by SoCalGas will be allocated to the consolidated portfolio to the extent that existing agreements for its brokering expire and is not otherwise committed.

Customers receiving procurement service from SoCalGas or SDG&E would pay the same rate for procurement service (including the cost of interstate capacity and storage). The allocation of the cost of intrastate transportation on the SoCalGas and SDG&E systems would not be affected by this proposal.

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[1] SoCalGas and SDG&E are affiliated companies, both being subsidiaries of Sempra Energy. They were authorized to merge in Decision (D.) 98-03-073, subject to a variety of conditions imposed to mitigate market power concerns.

Applicants assert that consolidating their gas acquisition management functions and their gas portfolios will generate savings that will be passed through to their gas customers through organizational efficiency. Currently, SoCalGas and SDG&E combined have about 54 people dedicated to gas acquisition functions. They estimate that by consolidating management, approximately 7 to 9 positions can be eliminated. This would produce an overhead savings (salaries, benefits, and associated support costs) of about one million dollars per year. These savings will be reflected in annual performance-based ratemaking (PBR) earnings sharing calculations until the next PBR/Cost of Service proceeding, at which time they will be embedded in the authorized revenue requirement.

Applicants claim additional benefits from consolidation. They say a larger organization will allow for better back-up and training, and better management of turnover. It will allow for improved senior management focus on a single organization. It will reduce the cost, both to the utilities and to the Commission, to regulate two separate portfolios and gas cost recovery incentive mechanisms. They contend consolidation will produce gas cost savings, as well as overhead savings, compared to the combined gas costs of the two utilities operating gas acquisition on a stand-alone basis.

Applicants identified three principal ways in which consolidation will save gas costs:

First, the reliability margin of gas in storage (or equivalent assets) that a consolidated portfolio will need to maintain can be somewhat less than the sum that each utility has to maintain when operating on a stand-alone basis; Second, consolidation will allow more economic use of the gas supplies, storage, and interstate capacity of the two utilities, especially of SDG&E's assets. Because of its size, existing trading organization, computer systems, and hub services organization, SoCalGas is better positioned than SDG&E to capitalize on core assets when they are not needed to serve procurement customers. Additional revenues are generated by physical gas transactions (off-system sales), capacity transactions, derivatives, and hub transactions. SDG&E contends that it is handicapped because its size does not support the systems needed to engage in those transactions; Third, increased load and supply diversity from consolidation will be beneficial. The access to Canadian supplies through the Pacific Gas and Electric Company system that SDG&E brings adds to the diversity of SoCalGas' core portfolio, which has no capacity on that route. Overall, SoCalGas and SDG&E estimate an annual savings of millions of dollars, depending on market conditions.

ORA supports applicants' consolidation proposal. ORA agrees that consolidation will produce 1) more efficient gas purchasing resulting in lower commodity costs because of the greater amount of natural gas being procured and greater diversity of demand being served, 2) more efficient use of storage and capacity assets, 3) greater efficiency in the cost of managing the utilities' gas procurement activities, and 4) regulatory efficiency. ORA also agrees that the combined purchasing power of the two utilities might be sufficient to counteract market power of suppliers, which would benefit California customers.

TURN supports consolidation provided that additional interstate capacity is reserved for the combined portfolio and that the revenue requirements for the two utilities be decreased on January 1, 2002. The city of Long Beach and El Segundo Power, LLC and Long Beach Generation, LLC support consolidation.

The only active party opposed to consolidation is SCGC.[2] It argues that the proposed merger of the core portfolios would improperly require SoCalGas' core ratepayers to subsidize SDG&E's core ratepayers; and insofar as the SoCalGas core has an independent need for reverting El Paso capacity, assigning the reverting El Paso capacity to the combined portfolio would fail to mitigate cross-subsidization of the SDG&E core by the SoCalGas core. SCGC contends that the SoCalGas core needs the reverting capacity for its own purposes, making the reverting capacity unavailable to offset the impact of combining the core portfolios; that combining the wholesale core loads with the SoCalGas core portfolio would require most of the reverting El Paso capacity that is independently needed by the SoCalGas core; that even if the reverting El Paso capacity were not needed independently by the SoCalGas core, the amount of reverting capacity would be insufficient to prevent the combining of the core portfolios from imposing a burden on the SoCalGas core; that the Sempra companies have proposed combining the core portfolios without analyzing the benefits and burdens on customers; that the Commission should not ignore market conditions and the impact on SoCalGas core ratepayers; and that the better course would be to avoid the benefit/detriment issues by having SDG&E maintain a competitive gas portfolio. Finally, SCGC asserts that assigning the reverting El Paso capacity to core customers without any offsetting benefit is unfair to noncore customers.

We will authorize consolidation of the gas acquisition portfolios of SoCalGas and SDG&E. ORA has succinctly described the benefits.

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[2] CIG/CMTA filed a Reply Brief in which it is "adopting various arguments advanced by the SCGC." (Reply Brief p. 1.)

Consolidation provides more efficient gas purchasing, lower gas costs, more efficient management, more efficient use of storage and capacity, lower overheads, less regulatory complexity, and increased rate stability for core customers. On the issue of market power the combined portfolio purchasing power will make it easier to counteract the "charge whatever the market will bear" mentality of out-of-state gas suppliers and transporters.

The protest of SCGC is factitious. It professes concern for the SoCalGas core through the entirety of its testimony and briefs, but represents no core ratepayers.[3] Those who do truly represent the core – ORA, TURN – and those who have core customers – SDG&E, SoCalGas, and Long Beach - support consolidation. SCGC's myriad objections can be winnowed down to two assertions: 1) that consolidation would constitute a subsidy by SoCalGas' core customers to SDG&E's core customers, and 2) that El Paso capacity that reverts to SoCalGas should continue to be brokered. Neither assertion is supported by the facts. We discuss the first assertion here and address reversion of El Paso capacity in the next section.

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[3] All SCGC members operate electric generation facilities located in the SoCalGas service territory.

SCGC argues that SoCalGas' core ratepayers would subsidize SDG&E's core ratepayers because the portfolio merger would permit the SDG&E procurement customers to access pipeline capacity held by the SoCalGas core. Under current market conditions, sharing pipeline capacity with SDG&E customers would expose the SoCalGas core to an additional cost of border gas purchases which the SoCalGas core could otherwise avoid. SCGC says until recently the market value of the core reservation was significantly lower than the as-billed rate charged by the pipelines to SoCalGas for the capacity. The difference between the market value and the as-billed rate represented a stranded cost. The SoCalGas core bore substantial stranded costs as a result of holding a reservation of El Paso and Transwestern capacity.

In contrast, SCGC argues, SDG&E customers substantially avoided stranded interstate pipeline costs. SDG&E entered into pipeline contracts for only a small portion of its demand. SDG&E's core procurement load is approximately 125 MMcf/d during an average year. SDG&E has only 35 MMcf/d of pipeline capacity under contract to serve that load. As a result, prior to December 2000, SDG&E's core has avoided paying the full as-billed pipeline transportation rate for most of its requirements. However, market conditions changed in late 2000. Border prices increased substantially, and SDG&E was exposed to that price risk. As a result, SDG&E's procurement charges for core customers increased to a level almost twice that of SoCalGas. Therefore, in the opinion of SCGC, merging the SoCalGas and SDG&E portfolios would expose SoCalGas ratepayers to high border prices that they would otherwise avoid. SCGC concludes that after years of having the SDG&E core realize the benefits of purchasing a majority of its gas supplies at border prices and avoiding interstate pipeline stranded costs, it would be unfair to combine portfolios at precisely the time that interstate pipeline capacity has started to provide value to the SoCalGas core.

SCGC's argument is without merit. It is merely speculation on the future border price of gas. Historically, in the 33 out of the 42 months prior to November 2000, SDG&E's border price was less than SoCalGas'. If we consider the recent spike in rates as an anomaly SDG&E would be better off not consolidating. SoCalGas and SDG&E are proposing to consolidate their portfolios for the long run. They are not proposing any date at which the consolidation would end. Rather, the gas procurement customers of each utility would pay the same procurement rate. Noncore customers are large enough and sophisticated enough to be able to hedge against price spikes. Ordinary core gas customers do not have that ability and it is in their interest for the utility serving them to provide this assurance. Consolidation avoids speculation; it recognizes the preference for rate stability for core customers. Further, consolidation reduces overheard, provides more efficient use of assets, increases utility purchasing power and, over time, should produce a downward pressure on rates.

2. Reversion of El Paso Capacity

SoCalGas proposes to allocate to the consolidated portfolio all available unassigned El Paso capacity held by SoCalGas. SoCalGas currently holds 300 MMcfd of firm capacity on Transwestern Pipeline and 1150 MMcfd of firm capacity on El Paso Natural Gas' pipeline, for a total of 1450 MMcfd. In the last SoCalGas BCAP, the Commission allocated 1044 MMcfd of that capacity (all 300 MMcfd on Transwestern, and 744 MMcfd on El Paso) to core service. The remaining amount, just under 400 MMcfd (all on El Paso) was unassigned. SoCalGas brokers this capacity, and any shortfall in the brokering revenues from the rate SoCalGas must pay El Paso is recovered by SoCalGas through the

Interstate Transition Cost Surcharge (ITCS). As the various contracts for brokering expire, SoCalGas and SDG&E propose that all available unassigned capacity on El Paso be allocated to the consolidated core portfolio. This would take place whenever various contracts for brokering expire, until the end of the term of the underlying SoCalGas contract with El Paso on August 31, 2006.

Some of the unassigned capacity is already brokered for the full remaining term of SoCalGas' El Paso contract. The following amounts of unassigned capacity will be available to SoCalGas upon expiration of contracts already signed: On November 1, 2001, SoCalGas will recover 160 MMcfd of capacity; on January 1, 2002, it will recover an additional 50 MMcfd; on March 1, 2003, to comply with existing contracts SoCalGas will transfer to third parties 100 MMcfd; on January 1, 2005, SoCalGas will recover 30 MMcfd of capacity. The amount of capacity that reverts to SoCalGas between November 1, 2001 and August 31, 2006 when the SoCalGas – El Paso contracts expire is never more than 210 MMcfd and after March 1, 2003, significantly less.

SoCalGas' current 1044 MMcfd core allocation is roughly equal to SoCalGas' average daily core load under average weather conditions. SDG&E will be adding about 125 MMcfd of core load to the consolidated portfolio, and will contribute about 25 MMcfd of firm interstate capacity from Canada and 10 MMcfd of firm capacity on El Paso (plus 3.6MMcfd capacity recently obtained in an El Paso open season). SDG&E's interstate capacity rights are just under 90 MMcfd less than its annual average core demand. The core loads of Long Beach and Southwest Gas are less than 20 MMcfd combined. The applicants assert that the addition to the consolidated portfolio of unassigned El Paso capacity that becomes available will ensure no dilution in the relative percentage of SoCalGas customer core load served by interstate capacity.

SoCalGas and SDG&E recommend that their core customers be committed to the allocation of all unassigned El Paso capacity at the as-billed rate, even if it later turns out that this capacity has a market value below the as-billed rate, and that the consolidated utility portfolio could have purchased supply more cheaply at the California border. The utilities do not believe that noncore customers have first claim on the unassigned El Paso capacity when it returns from being brokered. Applicants acknowledge that noncore customers have paid ITCS for the shortfall between the as-billed rate for interstate capacity and the amount for which SoCalGas could broker this capacity when the market value of the capacity was less than the as-billed rate. However, applicants maintain that ITCS has been allocated to and paid by wholesale customers and core customers, not just noncore retail customers. SDG&E customers in total have paid about 14.5% of total SoCalGas ITCS, while SoCalGas' other wholesale customers have paid 2.1%, and retail SoCalGas core customers have paid 12.6%.

SCGC argues that any capacity reverting to SoCalGas should continue to be brokered as in the past, with all revenue flowing to offset ITCS charges. It believes the noncore, having paid ITCS, should now get the benefit of capacity brokered above as-billed rates.

SCGC's argument has no merit. First, and again, it is mere speculation. There is no assurance that brokered capacity will cost more than the as-billed rate, just as there is no evidence that today brokered capacity costs more than as-billed; second, by assigning more capacity to the core at the as-billed rate, the noncore is protected from fluctuations in capacity charges and additional ITCS; third, ITCS costs exist because noncore customers are not required to pay the full as-billed rate for the unallocated 400 MMcf/d in capacity held by SoCalGas in excess of the core reservation. Calling it a burden ignores the fact that the noncore have paid less than the as-billed rate for this capacity. Meanwhile, core customers have paid as-billed rates for almost all their transportation needs plus ITCS, so that "when the difference between the as-billed rate and the market value of capacity reserved for the core is considered, it can be argued that core customers have actually paid more in stranded costs that the noncore." (D.99-11-021, *mimeo.*, at 38.) Fourth, and most important, we are required to assure reasonable rates and adequate service. Our concern is for the future. (D.01-03-082 at p. 51: "The Commission's first duty is to assure that customers of California public utilities receive reliable, safe service at reasonable rates.") To provide reasonable rates for the core requires additional capacity at a price that enhances rate stability: the as-billed rate. We emphasize that this result is based on the evidence in this record. In future proceedings if we find changed conditions, changed demand, changed capacity, our conclusions will differ.

ORA proposes that the returning capacity of 50 MMcfd, which is to be delivered at El Paso-Topock on January 1, 2002, be optimized such that the portion of capacity available for delivery at SoCalGas-Topock would be allocated to the core portfolio in exchange for non-SoCalGas delivery point capacity. According to ORA's estimate the 50 MMcfd was allocated as follows: 20 MMcfd at the SoCalGas delivery point; 16 MMcfd at the PG&E delivery point and 13MMcfd at the Mojave delivery point. Under ORA's recommendation, the core would obtain an additional allocation about 21 MMcfd at the SoCalGas delivery point in exchange for a similar amount at the PG&E and/or Mojave – Topock delivery point(s).[4]

ORA contends that the El Paso capacity associated with SoCalGas delivery points is more valuable to the core than non-SoCalGas delivery point capacity because it can be delivered directly to end-use customers and does not have to be rerouted. When SoCalGas uses the non-SoCalGas delivery point capacity to flow gas into the SoCalGas system, there is an extra transportation cost on Mojave and PG&E to get the gas to the SoCalGas Wheeler Ridge delivery point.

SoCalGas and SDG&E agree that this approach would probably be more favorable for the core customers served out of the consolidated portfolio than the portfolio simply keeping all the additional 50 MMcfd for as long as it is available. However, SoCalGas and SDG&E do not believe ORA's proposal is fair to noncore customers, as it can be expected to increase their ITCS burden. SoCalGas and SDG&E believe that it is appropriate to allocate currently unassigned El Paso capacity to the consolidated utility portfolio at the as-billed rate, but ORA's proposal is excessive. SoCalGas and SDG&E maintain that to get the benefit of allocation of reverting capacity in excess of the currently-allocated 1044 MMcfd, the core should take the risk and reward of holding all of that

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[4] In support of its argument for optimization of 50 MMcf/d of capacity, ORA appends to its Reply Brief as Attachment A a spreadsheet entitled "Summary of Capacity Release Transactions as of January 5, 2001." In footnote 1 to its Reply Brief, ORA moves that the attachment be received into evidence as a late-filed exhibit. SCGC and CIG/CMTA object. They argue that ORA would have Attachment A received as a late-filed exhibit without an opportunity for other parties to conduct discovery or to cross-examine an ORA witness. They point out that the evidentiary phase of this proceeding was closed without receipt of evidence on any of the factual questions raised by ORA's "optimization" issue. Given the lack of evidence, the issue should not be considered in this proceeding. We agree; ORA's late-filed exhibit will not be received.

capacity at the as-billed rate for the remainder of the term of the underlying SoCalGas-El Paso contract (*i.e.*, through August, 2006).

We believe the record is inadequate to support finding regarding delivery points at this time, an issue that was not raised during the hearings, especially when SoCalGas must transfer 100 MMcfd to third parties 14 months after receiving 50 MMcfd on January 1, 2002. It is more appropriate to wait for SoCalGas' next proceeding which considers capacity for the core.

3. Revised Rules for Core Transportation[5] and Procurement Services

SoCalGas and SDG&E propose revisions to rules applicable to noncore-to-core transfers, and to large core customers switching from transportation-only to bundled core utility procurement service. There appears to be relatively little opposition to SoCalGas' and SDG&E's proposals in these areas. They propose revised rules for their noncore customers wishing to take core transportation-only service or bundled core transportation and utility procurement service. Currently, the two utilities' rules in these areas are somewhat different, both as a result of Resolution G-3304 imposing a moratorium on election of core transportation and core procurement and of other differences adopted in the past. Given the consolidation of the two utilities' gas portfolios, it is appropriate to adopt uniform rules for election of core transportation and procurement by noncore customers of each of the two utilities.

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[5] Throughout the testimony and briefs, the parties have used the phrase "transportation service" and "transmission service" interchangeably. In this decision we use only the phrase "transportation service." Similarly, we use the phrase, "transportation rate" rather than "transmission rate."

SoCalGas and SDG&E propose that electric generation, refinery, and enhanced oil recovery (EOR) customers of either utility, any of whom consume over 250,000 therms per year, should not be able to choose core transportation service or bundled core transportation and utility procurement service. Other customers with noncore status, after expiration of any firm contracts they already have with their utility, would have the option to switch to core transportation-only service or bundled core transportation and utility procurement service. Moreover, SoCalGas and SDG&E propose that noncore firm service customers be given a one-time option to cancel their existing firm service contract in order to elect core service, provided the election occurs within three months of the effective date of the new service.

SoCalGas and SDG&E propose that they not be required to accept elections by noncore customers for core transportation service if existing utility intrastate capacity is not sufficient, to prevent service to traditional core customers becoming degraded. Customers electing core transportation service should have to commit to a five-year term, rather than a one-year term as is currently required. They would pay the applicable core transportation rates for their class of service, rather than noncore transportation rates. The utilities point out that because core transportation service means a one-in-35 year level of reliability, additional demands on transmission and storage resources will be created. Transmission and storage facilities are long-lived investments. The utilities believe, therefore, that it is reasonable that noncore customers wishing to switch to core transportation service should have to make a five-year commitment before the utility is committed to long-lived assets necessary to provide that level of service.

The utilities propose that noncore customers switching to bundled core transportation service and utility procurement service be required for the first 12 months to pay a "cross-over" procurement rate. The cross-over rate would be the higher of a) the posted monthly core procurement rate (which will include intrastate backbone costs) or, b) the GCIM monthly benchmark for California border purchases plus the per-unit cost of intrastate backbone costs included in the posted monthly procurement rate (because the California border price alone does not cover the cost of intrastate backbone capacity and it will no longer be recovered in the transportation rate). For the remaining four years, the procurement rate would be the same as charged to core customers.

SoCalGas and SDG&E claim that the combination of the five-year commitment and the cross-over rate for the first 12 months of that five years will be sufficient to prevent price arbitrage and protect existing core customers. The cross-over rate will discourage switching to avoid the impact of short-term border price spikes. The five-year commitment will prevent opportunistic switching in and out of utility procurement service. Also, the five-year commitment will allow the utilities to better plan contracts for gas supply and associated storage and interstate pipeline capacity. SoCalGas and SDG&E recommend that they be allowed to propose by advice letter an additional surcharge to the cross-over rate if the provision turns out to be insufficient to avoid the imposition of significantly higher costs on existing core customers.

The utilities assert that the five-year commitment of a customer consuming over 250,000 therms per year[6] electing core transportation service should carry an 80% use-or-pay requirement (as applied to the core transportation rate) should the customer fuel switch or bypass utility service, as is the case already for noncore customers contracting for firm noncore transportation service (as applied to the noncore transportation rate). The five-year commitment to utility procurement service should carry a 14% take-or-pay requirement in the case of fuel switching or bypass, as now provided for core subscription.

The utilities propose that noncore customers who were already receiving core subscription service before January 1, 2001, should be allowed to switch to bundled core transportation and utility procurement service (with a five-year commitment) on the effective date of this decision, if they are still on core subscription service as of that date, without having to pay the cross-over procurement rate. Currently they receive procurement service at an average portfolio price and did not elect utility procurement service because border prices had spiked.

SDG&E's noncore customers who began core subscription service on and after January 1, 2001, have effectively been paying a rate roughly equivalent to the cross-over rate. Therefore, the utilities' recommend that those customers who elect bundled core transportation and utility procurement service offered as a result of this application should only have to pay the cross-over rate for a period not to exceed 12 months after they commenced core subscription service from SDG&E.

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[6] This category of customer does not include electric generation, refinery, and EOR customers.

In Resolution G-3304, the Commission made special provision for SoCalGas' noncore customers whose gas supplier withdrew from service in California altogether and who in the judgment of SoCalGas would be left without service, allowing them an exemption from the moratorium on new core subscription customers. SoCalGas believes such customers could be exempted from the cross-over rate for utility procurement service, but should be required to make a five-year commitment for core transportation and utility procurement service.

ORA generally supports applicants' proposed rules for noncore customer transfers to core service, but recommends that eligible noncore customers electing transportation-only service be required to make a permanent commitment to that service instead of just five years. ORA agrees that a customer switching from noncore service to core service with its one-in-thirty-five year reliability criteria creates additional demands on transportation and storage resources requiring the utilities to make substantial commitments that generally last a number of years. Therefore, ORA argues, the customer should be required to make a commensurate commitment to taking core service, which in this case should be a permanent commitment. The storage, transportation, and distribution facilities of the utility are typically depreciated over useful lives of over 40 years. If the utilities make investments of plant with useful lives of over 40 years to serve new core customers, then allowing these customers to opt out after just five years would leave these additional costs to be allocated to traditional core customers. The traditional core customers would then be responsible for the investments required to serve the switching noncore customers that were provided a higher level of service as core customers.

Consequently, those customers should not have the option of moving into and then out of core service, even for a five-year period.

We agree with the utilities that a five-year commitment, including cross-over rates as proposed and as applicable, is sufficient to prevent gaming and to facilitate appropriate long-term utility planning. Requiring a permanent commitment to core service would be impractical and could also result in gaming. We therefore adopt the utilities' proposed rules for noncore election of core transportation and procurement services.

4. Core Subscription

Core subscription has been the option (closed on an interim basis to additional customers on the SoCalGas system by Resolution G-3304) under which noncore customers have had ability to maintain their noncore status for transportation service priority (and rates), but take procurement service from the two utilities' core gas portfolios. In D.01-12-018 in Investigation (I.) 99-07-003, the Commission terminated core subscription. This issue therefore does not require further discussion in this proceeding.

5. Core Aggregation Transportation (CAT)

Under existing rules, any core customer switching from CAT marketer procurement service to utility procurement service pays the regular core procurement rate for such service, but must return to utility procurement service for a minimum of 12 months. The one exception is that the customer may switch to a different CAT marketer within 90 days of returning to utility procurement service. This exception can lead to gaming of the market place.

The greatest risk of gaming involves larger core customers. In order to prevent such gaming, SoCalGas and SDG&E propose new rules for core customers with annual consumption over 50,000 therms who want to switch from a CAT marketer to utility procurement service. The utilities propose that these customers should be required to pay the cross-over rate as described above for the first 12 months of utility procurement service. Should the Commission decide to give exemptions to customers whose marketer withdraws from California, then a core customer of the marketer consuming over 50,000 therms per year who returns to utility procurement service would not have to pay the cross-over rate. Such a customer would have 90 days to find a different CAT marketer or be committed to utility procurement service for a full 12 months. However, if the customer chose a different CAT marketer within 90 days, the customer would be charged the cross-over rate for the procurement service it received from the utility within those 90 days.

SoCalGas and SDG&E believe the potential for abuse by core customers under 50,000 therms is small enough due to transaction cost barriers that no change in the current CAT rules applicable to them is necessary. There is no objection to the utilities' proposal; it is reasonable and will be adopted.

6. The Long Beach Agreement

SoCalGas/SDG&E and Long Beach jointly presented a proposal for giving wholesale customers of SoCalGas an option to purchase gas from the consolidated SoCalGas/SDG&E gas portfolio. This proposal provides the wholesale customers with treatment comparable to that which SDG&E will receive. It treats core customers of the wholesale customers as if they were SoCalGas/SDG&E core customers and noncore customers of the wholesale customers as if they were SoCalGas/SDG&E noncore customers.

ORA objects to only one aspect of the proposal. The proposal provides that the wholesale customer would be charged the cross-over rate for 12 months with respect to the load of any eligible noncore customer of the wholesale customer that elected bundled service from the wholesale customer after January 1, 2001. ORA proposes, instead, that SoCalGas charge the cross-over rate for 12 months for all eligible noncore load of the wholesale customer, even if that load was getting procurement service from the wholesale customer prior to January 1, 2001.

Under the SoCalGas/SDG&E proposal for their retail noncore customers who were already receiving core subscription service from SoCalGas or SDG&E before January 1, 2001, those customers would be allowed to switch to bundled core transportation and procurement service without paying the cross-over rate. The proposal they have made for the load of eligible noncore customers of wholesale customers who were already receiving procurement service from the wholesale customer before January 1, 2001, is that those customers not pay the cross-over rate. In our opinion the utilities' proposal provides more consistency in treatment of noncore customers in the various service territories than does ORA's proposal. There is no need for a cross-over rate for those customers.

7. Tolling Arrangements

SoCalGas and SDG&E propose that the management of their combined gas acquisition department be allowed to assist SDG&E with respect to "tolling"[7] arrangements for wholesale power purchases to serve SDG&E's electric customers. Currently, SDG&E has a joint gas-and-electric procurement department, which operates independently of SoCalGas' gas acquisition department. The utilities contend that if the management of SoCalGas and

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[7] "Tolling" in the context of power purchase contracts refers to arrangements in which the purchaser of power from a generator provides the gas needed to generate the power, or makes other arrangements such that the generator is not at risk for variation in the price of gas consumed to produce the power.

SDG&E's gas acquisition functions are consolidated in a single department, it makes sense to allow SDG&E's electric procurement management to have access to the gas expertise of the consolidated gas procurement department, just as SDG&E's electric procurement management today has access to the gas procurement expertise of its own gas buyers.

SCGC argues that this proposal would give core priority to transportation of gas to generators with whom SDG&E has tolling arrangements. SoCalGas and SDG&E respond that merely because a tolling supply agreement was managed by the consolidated gas acquisition group would not confer any elevation in curtailment priority. ORA opposes the proposal on the ground that it is premature. SDG&E is not expected to purchase power prior to January 1, 2003, when Department of Water Resources' (DWR) authority to purchase power for SDG&E expires.

Because of the controversy regarding this issue and the paucity of evidence to support either party's position, we believe the public interest will benefit by a fuller evidentiary record. Therefore, we defer this issue to a later proceeding. ORA notes that pending resolution of this issue SDG&E's electric department can handle any needed arrangements for its power suppliers.

8. Impact of D.01-12-018 (SoCalGas and SDG&E Gas Structure)

On December 11, 2001, the Commission issued D.01-12-018 in I.99-07-003, our investigation into gas regulatory strategy. D.01-12-018 adopted with modifications the Comprehensive Settlement Agreement (CSA) that had been submitted in that proceeding by numerous parties, including SoCalGas and SDG&E. Pursuant to a request for comments on whether D.01-12-018 affected any of the issues raised in this application, SoCalGas and SDG&E filed joint comments and SCGC filed comments.

The utilities say that the adoption of D.01-12-018 has some impacts on this application. D.01-12-018 provides that SoCalGas and SDG&E should no longer offer gas procurement service to noncore customers. Thus, terms and conditions of gas procurement service for noncore customers need not be adopted. Also D.01-12-018 lifted the prohibition on SoCalGas' noncore customers transferring to core service, but did not address any terms and conditions for such transfers. The CSA provides for contracts for utility procurement service to noncore customers already in existence to run to their conclusion, at which time the noncore customer could no longer take procurement service from the utility. Noncore customers in this category who fail to designate a marketer would be transferred to bundled core transportation and procurement service. We have considered in this application the terms and conditions for such transfers by both SoCalGas and SDG&E noncore customers. D.01-12-018 has some implications for the proposed consolidation of the SoCalGas and SDG&E gas supply portfolios, but nothing in derogation of the consolidation.

In regard to the transfer of a noncore customer to core status, D.01-12-018 stated:

> We note that G-3304 suspended transfers to core subscription service and core service as of December 20, 2000. As discussed above, it is our intention to provide customers with the option of choosing between noncore status, with its attendant responsibilities, and the bundled core. In order to provide this option, this decision rescinds that portion of Resolution G-3304 which suspended transfers to bundled core service, as of the effective date of this decision. (*mimeo.*, p. 90.)

SoCalGas Advice Letter 3100 filed on December 26, 2001, lifted the moratorium adopted in G-3304 on SoCalGas noncore customers transferring to core status.

In this application, SoCalGas and SDG&E proposed terms and conditions under which their noncore customers could elect to transfer to core status. They proposed that there be a limitation on which noncore customers could elect core status, excluding electric generation (EG), enhanced oil recovery (EOR) and refinery noncore customers from eligibility for this transfer. SoCalGas and SDG&E also proposed other restrictions discussed above in Section 3.

SCGC argues that because D.01-12-018 lifted the ban on noncore to core transfers, all noncore customers currently have the option of continuing with noncore service or transferring to bundled core service, contrary to what SoCalGas proposes. Rather than permitting noncore customers to have the option to transfer to core service, SoCalGas proposes to restrict the right to transfer to core service so as to prevent transfers by electric generation, refinery, and enhanced oil recovery customers who consume over 250,000 therms per year. SCGC says SoCalGas' proposal to restrict the opportunity for certain noncore customers to transfer from noncore to bundled core service flatly contradicts D.01-12-018. That decision grants to all noncore customers an option to transfer to bundled core service without restriction. Accordingly, SoCalGas' proposal to continue a prohibition on noncore to core transfers by electric generation, refinery, and enhanced oil recovery customers should be dismissed as an issue in this proceeding.

SCGC asserts that the SoCalGas/SDG&E proposal to combine core portfolios violates D.01-12-018 and should be dismissed as an issue. It argues that the utilities do not have the requisite capacity to serve the combined portfolio, and it would be speculative to assume that they would be able to get the capacity under the terms of the CSA.

Southwest Gas Corporation supports SoCalGas and SDG&E. It says consolidation of their core portfolios is consistent with the CSA. The utilities now serve their individual core markets and any combination of core procurement services would entail a requisite combination of resources used to provide for those core markets.

SCGC's objections are without merit. It argue that the utilities do not have enough capacity to serve their traditional core customers - residential and small business – but it wants the opportunity for its membership, the largest users of gas in California, to become core customers. Adopting SCGC's proposals is patently contradictory and unfair.

9. Comments on Draft Decision

The proposed decision of the Administrative Law Judge was mailed to the parties in accordance with Pub. Util. Code § 311(d) and Rule 77.1 of the Rules of Practice and Procedure. Comments were received and to the extent applicable were incorporated in this decision.

Findings of Fact

1. SoCalGas and SDG&E will operate more efficiently and economically when they consolidate the management of their currently separate gas acquisition departments, and consolidate their gas supply portfolios, including associated storage and interstate capacity.

2. Consolidating applicants' gas acquisition management functions and their gas portfolios will generate savings to be passed through to their gas customers through organizational efficiency.

3. SoCalGas and SDG&E combined have about 54 people dedicated to gas acquisition functions. By consolidating management, approximately 7 to 9

positions can be eliminated. This would produce an overhead savings (salaries, benefits, and associated support costs) of about one million dollars per year.

4. Consolidation will produce: 1) more efficient gas purchasing resulting in lower commodity costs because of the greater amount of natural gas being procured and greater diversity of demand being served, 2) more efficient use of storage and capacity assets, 3) greater efficiency in the cost of managing the utilities' gas procurement activities, 4) rate stability for core customers, and 5) regulatory efficiency.

5. The combined purchasing power of the two utilities might be sufficient to counteract market power of suppliers, which would benefit California customers.

6. Consolidation avoids speculation by SDG&E regarding the border price of gas.

7. On November 1, 2001, SoCalGas recovered 160 MMcfd of El Paso capacity; on January 1, 2002, it recovered an additional 50 MMcfd; on March 1, 2003, to comply with existing contracts, SoCalGas will transfer to third parties 100 MMcfd; on January 1, 2005, SoCalGas will recover 30 MMcfd of capacity. The amount of capacity that reverts to SoCalGas between November 1, 2001 and August 31, 2006 when the SoCalGas – El Paso contracts expire is never more than 210 MMcfd and after March 1, 2003, significantly less.

8. SoCalGas' and SDG&E's core customers should be allocated all unassigned El Paso capacity that becomes available until the end of the underlying contract in 2006, or until the Commission issues a decision in the next SoCalGas proceeding which considers capacity for the core, whichever comes first.

9. SoCalGas' current 1044 MMcfd core allocation is roughly equal to SoCalGas' average daily core load under average weather conditions. SDG&E will be adding about 125 MMcfd of core load to the consolidated portfolio, and

will contribute about 25 MMcfd of firm interstate capacity from Canada and 10 MMcfd of firm capacity on El Paso (plus 3.6 MMcfd capacity recently obtained in an El Paso open season). SDG&E's interstate capacity rights are just under 90 MMcfd less than its annual average core demand. The core loads of Long Beach and Southwest Gas are less than 20 MMcfd combined. Thus, the addition to the consolidated portfolio of unassigned El Paso capacity that becomes available will ensure no dilution in the relative percentage of SoCalGas customer core load served by interstate capacity.

10. The core requires additional capacity at a price that enhances rate stability; the as-billed rate achieves this objective.

11. There is insufficient evidence on which to base a finding regarding a change in delivery points for gas.

12. It is appropriate to adopt uniform rules for election of core transportation and procurement service by noncore customers of each of the two utilities.

13. SoCalGas and SDG&E are not required to accept elections by noncore customers for core transportation service if existing utility intrastate capacity is not sufficient, to prevent service to traditional core customers becoming degraded.

14. Noncore customers who were already receiving core subscription service before January 1, 2001, are allowed to switch to bundled core transportation and utility procurement service on the effective date of this decision, if they are still on core subscription service as of that date, without having to pay the cross-over procurement rate.

15. Wholesale customers of SoCalGas may purchase gas from the consolidated gas portfolio on terms comparable to that which SDG&E will receive.

16. SDG&E's electric customers should be permitted to benefit from the expertise available in the consolidated gas acquisition group as a means of reducing costs and ameliorating electric rates.

Conclusions of Law

1. It is reasonable that SoCalGas and SDG&E:

   a. Consolidate their gas supply portfolios and related interstate pipeline and storage capacities, and charge the same cost of gas to utility procurement customers in their service territories.

   b. Consolidate the management of their separate gas acquisition functions into a single management group.

   c. Implement revised uniform rules for their noncore customers wishing to obtain core service from them.

   d. Implement revised uniform rules for large core customers who wish to obtain utility procurement service after having first elected transportation-only service.

   e. Allow non-affiliated wholesale customers to purchase gas from their combined portfolio on terms that are reasonable for all affected core gas consumers.

   f. Reallocate unassigned SoCalGas capacity on the El Paso Natural Gas Company's pipeline to the two utilities' consolidated gas supply portfolio.

2. The combined gas acquisition organization must remain separate from the utilities' gas operations organizations, as required by SoCalGas/SDG&E merger conditions.

3. ORA's motion to receive into evidence Attachment A in its Reply Brief is denied.

4. Any cost reductions created by the consolidation should be reflected in the applicants next rate cases.

5. This decision is effective today in order to allow these changes to take place expeditiously.

O R D E R

IT IS ORDERED that:

1. Within 30 days after the effective date of this decision Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) shall file revised tariff schedules, subject to the approval of the Energy Division, implementing the Findings of Fact and Conclusions of Law of this decision. The revised tariff schedules shall comply with General Order 96-A and shall apply to services rendered on or after their effective date.

2. The cost of all gas supplies and associated storage and interstate capacity currently held by SoCalGas and SDG&E shall be included in the combined portfolio.

3. All new gas supplies and assets shall be included in the combined portfolio.

4. Unassigned El Paso capacity held by SoCalGas shall be allocated to the consolidated portfolio to the extent that existing agreements for its brokering expire and it is not otherwise committed. This allocation shall be effective until the Commission issues a decision in the next SoCalGas proceeding which considers capacity for the core.

5. Customers receiving procurement service from SoCalGas or SDG&E shall pay the same rate for procurement service (including the cost of interstate capacity and storage).

6. Electric generation, refinery, and enhanced oil recovery (EOR) customers of either utility, any of whom consume over 250,000 therms per year, may not

choose core transportation service or bundled core transportation and utility procurement service.

7. Other customers with noncore status, after expiration of any firm contracts they already have with their utility, have the option to switch to core transportation-only service or bundled core transportation and utility procurement service. Noncore firm service customers have a one-time option to cancel their existing firm service contract in order to elect core service, provided the election occurs within three months of the effective date of the new service.

8. Noncore customers switching to bundled core transportation service and utility procurement service are required to pay a cross-over procurement rate for the first 12 months. The cross-over rate is the higher of a) the posted monthly core procurement rate (which will include intrastate backbone costs) or, b) the GCIM monthly benchmark for California border purchases plus the per-unit cost of intrastate backbone costs included in the posted monthly procurement rate.

9. Noncore customers who elect bundled core transportation and utility procurement service, shall be required to pay the cross-over rate for a period not to exceed 12 months after they commenced core subscription service from SDG&E.

10. Noncore customers electing transportation-only service or bundled transportation and utility procurement service are required to make a five-year commitment to that service.

11. Core customers with annual consumption over 50,000 therms who want to switch from a CAT marketer to utility procurement service may do so. These customers are required for the first 12 months of utility procurement service to pay the cross-over rate. A core customer consuming over 50,000 therms per year who returns to utility procurement service because his CAT left California does

not have to pay the cross-over rate. Such a customer has 90 days to find a different CAT marketer or be a committed to utility procurement service for a full 12 months. However, if the customer chose a different CAT marketer within 90 days, the customer will be charged the cross-over rate for the procurement service it received from the utility within those 90 days.

12. Core customers of the wholesale customers shall be treated as if they were SoCalGas/SDG&E core customers and noncore customers of the wholesale customers shall be treated as if they were SoCalGas/SDG&E noncore customers.

13. This proceeding is closed.

This order is effective today.

Dated ____________________________, at San Francisco, California.

ATTACHMENT A

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