Decision 05-05-033 May 26, 2005

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southwest Gas Corporation for Approval of a Gas Cost Incentive Mechanism. (U 905)	Application 04-11-009 (Filed November 12, 2004)

OPINION ON SOUTHWEST GAS CORPORATION'S APPLICATION FOR APPROVAL OF A GAS COST INCENTIVE MECHANISM

Summary

Our decision today approves Southwest Gas Corporation's (Southwest) application to establish a gas cost incentive mechanism (GCIM). The adopted GCIM will provide an objective standard by which to measure Southwest's gas procurement performance, an incentive to lower overall gas costs, and a sharing of gas procurement benefits between ratepayers and Southwest.

Background

In Decision (D.) 04-03-034,[1] Southwest's last general rate proceeding, the Commission encouraged Southwest to establish a GCIM as a means to reduce gas costs for ratepayers, and as an incentive to shareholders to benefit from improved gas purchase procedures. On November 12, 2004, Southwest filed

[1] *See* p. 74.

Application (A.) 04-11-009 (Application) requesting Commission approval of a proposed GCIM, and also expedited *ex parte* action on the Application.

Southwest states that its proposed GCIM will establish objective standards to measure gas procurement performance, and a methodology to share annual savings and costs between Southwest's shareholders and customers. The proposed GCIM will set a volume-weighted performance benchmark to determine the savings or costs resulting from differences between the benchmark and Southwest's actual annual gas costs. Southwest explains that its GCIM proposal is a result of extensive collaboration with the Office of Ratepayer Advocates (ORA) during the past several months, and that its GCIM proposal is patterned after existing gas cost incentive mechanisms currently authorized for other California utilities. Southwest requests Commission approval of the GCIM that is detailed in proposed tariff sheets appended to the Application.

On December 15, 2004, ORA filed a response to the Application, noting that it has been involved with the review and development of Southwest's GCIM proposal, and as a result, ORA supports Southwest's proposal as submitted. ORA points out that under the proposed GCIM methodology, gas commodity costs are compared against market prices represented by indices used in the benchmark. Furthermore, the commodity benchmark also includes a component for purchases under Southwest's "Volatility Mitigation Program" (VMP) which are fixed price contracts entered into for price mitigation. The VMP purchases are flowed through, and thus have no impact on GCIM rewards or penalties.[2]

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[2] VMP purchases are limited to 25% of the forecasted annual gas supply.

Transportation and storage costs are also flowed through and do not impact the GCIM.

ORA explains that the shared savings or costs occur when the actual purchased costs are outside of either the upper or lower tolerance bands calculated as a percentage of the annual gas cost benchmark. The upper tolerance band is the GCIM benchmark plus 3% of the gas commodity benchmark, while the lower tolerance band is the GCIM benchmark minus 2% of the gas commodity price benchmark. Costs exceeding the upper tolerance band are shared 50%-50% between shareholders and ratepayers. If purchased gas costs are below the lower tolerance band, 75% of the savings go to ratepayers, and 25% go to shareholders. In addition, there is a "cap" on shareholder rewards equal to 1.5% of the respective actual commodity costs.

As further explained by ORA, the proposed GCIM also includes a storage capacity target of 80% by November 1,[3] reporting requirements including an annual GCIM compliance filing, and a requirement for an advice letter filing to reflect shared savings or costs requesting authorization for the appropriate accounting entries.

ORA states there are no disputed issues of fact, and that it believes hearings are not necessary.

No other responses to the Application have been received**.**

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[3] The GCIM requires Southwest to have storage reserves filled to a target level of 80 percent of capacity by November 1, of each year. Failure to meet the 80 percent target requires Southwest to explain the variance to core customers in the annual GCIM filing.

Discussion

In Investigation (I.) 01-06-047, we reviewed the reasonableness of Southwest's gas purchase practices, and although a GCIM was discussed, D.02-08-047 in I.01-06-047 did not adopt any gas purchase incentive mechanism. Later in A.02-02-012, we again reviewed Southwest's gas purchases, and encouraged Southwest to file an application to establish a GCIM. In response to our encouragement, Southwest's proposed GCIM establishes a reasonable benchmark from which to measure the success of gas purchases, provides incentives to reduce gas purchase costs for ratepayers and shareholders, and provides ratepayers with protections from unreasonable gas purchases.

Our review of the proposed GCIM indicates it meets our purposes for a gas purchase incentive mechanism for Southwest. First, the GCIM establishes reasonable benchmarks[4] through a volume-weighted average based on actual trading points and published gas prices, thus protecting ratepayers by establishing objective standards of measurement. Second, the GCIM provides relatively narrow tolerance bands (2% and 3% of the benchmark price) within which to determine additional costs or savings, thus sharpening the purpose of the incentive mechanism. Third, the allocation of additional costs and savings is balanced in favor of ratepayers. Although additional costs are shared on a 50-50 basis, savings are allocated 75% to ratepayers, and only 25% to shareholders. Fourth, the cap on shareholder rewards of 1.5% of actual commodity costs means that the mechanism will not unreasonably reward shareholders, should gas costs suddenly decline. Fifth, the GCIM provides Commission oversight through

[4] The GCIM proposal establishes a GCIM for Southwest's Southern Division, and a GCIM for Southwest's Northern Division.

reporting requirements and advice letter filings, subject to further review for reasonableness, before either additional costs or savings are passed on to ratepayers. Sixth, through the storage reserve target level of 80% of capacity, the GCIM provides that Southwest will endeavor to dispatch gas supplies into and out of storage in a manner that provides the greatest economic benefit to ratepayers based on available market information. Finally, establishing a GCIM for Southwest will reduce or eliminate the need for the Commission, and its staff, to investigate, analyze, and participate in proceedings regarding the reasonableness of Southwest's gas purchases.

Conclusion

For all of the foregoing reasons, we grant the Application of Southwest to establish a GCIM.

In I.02-11-040, we are investigating the gas market activities of the major gas utilities we regulate and the impact of those activities on the gas price spikes experienced during 2000 and 2001. Our actions here do not prejudge any actions we may take in I.02-11-040.

Categorization and Need for Hearings

In Resolution ALJ 176-3142, dated November 19, 2004, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. ORA filed a response supporting the Application as filed. Given this status, public hearing is not necessary and the preliminary determinations made in Resolution ALJ 176-3142 with regard to categorization and hearings should not be altered.

Waiver of Comments

Since this proceeding is uncontested and we grant the relief requested, pursuant to Section 311(g)(2), the otherwise applicable 30-day period for review and comment is waived.

Assignment of Proceeding

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

Findings of Fact

1. The proposed GCIM sets a volume-weighted performance benchmark in order to determine savings or additional costs from differences between the benchmark and actual gas purchases.

2. The proposed GCIM uses actual gas trading points and published gas prices, thereby establishing objective standards of measurement and thus protecting ratepayers.

3. The lower and upper tolerance bands are set at 2 and 3 percent of the benchmark, respectively. These relatively narrow bands improve the purpose of the incentive mechanism in the GCIM.

4. The GCIM commodity benchmark includes a factor for VMP purchases which flows through VMP purchases, and thus has no effect on the GCIM rewards or penalties.

5. Transportation and storage costs are flowed through the GCIM and thus do not impact GCIM rewards or penalties.

6. Actual gas purchase costs exceeding the upper tolerance band are shared 50 percent to ratepayers and 50 percent to shareholders.

7. Actual gas purchase costs which are lower than the lower tolerance band provide 75 percent of savings to ratepayers, and 25 percent of savings to shareholders.

8. The allocation of costs and savings using the tolerance bands provide a net benefit in favor of ratepayers.

9. The GCIM includes a cap on shareholder savings equivalent to 1.5 percent of actual commodity costs, thus protecting ratepayers against unusual declines in gas prices.

10. The GCIM includes a storage reserve target of 80 percent of annual capacity, which provides an economic benefit to ratepayers.

11. Establishing a GCIM will reduce or eliminate the need for Southwest, the Commission and Commission staff to investigate, analyze and participate in proceedings on Southwest's annual gas purchases.

12. ORA worked with Southwest to develop the GCIM included in this Application.

Conclusions of Law

1. The proposed GCIM, as described in the tariffs accompanying Southwest's application, is a reasonable mechanism to establish gas purchase costs for ratepayers and provide an incentive to Southwest to reduce purchased gas costs.

2. This is ratesetting proceeding.

3. The proposed GCIM allocates additional gas purchase costs and savings to shareholders and ratepayers in a manner that benefits ratepayers.

4. There are no disputed issues of fact and therefore hearings are not necessary.

5. Since no one objected to Southwest's Application to establish a GCIM and this decision grants the relief requested, we waive public review and comment pursuant to Pub. Util. Code § 311(g)(2) on this decision.

6. In order that ratepayers may immediately benefit from establishing the GCIM in this Application, this decision should be effective today.

O R D E R

IT IS ORDERED that:

1. The November 12, 2004 application of Southwest Gas Corporation to establish a Gas Cost Incentive Mechanism is approved.

2. This order is a final determination that a hearing is not needed in this proceeding.

3. Application 04-11-009 is closed.

This order is effective today.

Dated May 26, 2005, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN
SUSAN P. KENNEDY
DIAN M. GRUENEICH
JOHN A. BOHN
Commissioners