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Decision 90-11-033 November 9, 1990

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

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| In the Matter of the Application of San Diego Gas & Electric Company, for authority to revise its Energy Cost Adjustment Clause Rate, to revise its Annual Energy Rate, and to revise its Electric Base Rates effective May 1, 1990 in Accordance with the Electrical Revenue Adjustment Mechanism. (U 902-E) | Application 89-09-031 (Filed September 29, 1989) |

(See D.90-05-090 for appearances.)

## OPINION

### Background

This decision resolves outstanding issues in the San Diego Gas and Electric Company (SDG&E) annual Energy Cost Adjustment Clause (ECAC) filing which covers the following:

1. Calculation of adjustment for ECAC, Annual Energy Rate, Electric Revenue Adjustment Mechanism rates;

2. Proposed revenue allocation and rate design to implement the rate adjustments;

3. Proposed energy and capacity payments to certain qualifying facilities during the forecast period May 1, 1990 through April 30, 1991, and;

4. Reasonableness review of its gas and electric operations during the record period from May 1, 1988 through July 31, 1989.

A prehearing conference was held before Administrative Law Judge (ALJ) Frank J. O'Leary at San Francisco on October 16, 1989, at which time it was determined that the hearing process

would be bifurcated into two phases: first, the forecast phase, and second, the reasonableness phase. This decision deals only with the reasonableness phase. The forecast phase was resolved in Decision (D.) 90-05-090 (May 22, 1990).

Public hearings were held before ALJ O'Leary in San Diego on March 12, 13, and April 2, 1990. The reasonableness phase was submitted subject to the filing of concurrent opening briefs on May 2, 1990 and concurrent reply briefs on May 18, 1990. Timely briefs were filed by the applicant and Division of Ratepayer Advocates (DRA).

DRA reviewed SDG&E's gas supply and storage management, gas system and operations, gas procurement policy and practices, and gas operating plans for the record period May 1, 1988 to July 31, 1989. The normal record period covers 12 months; however, D.89-01-040, which modified the schedule for the processing of energy offset proceedings, revised the record period to 15 months for this proceeding only.

DRA found SDG&E's energy operations and expenses to be reasonable for the record period except for the purchase of natural gas under a contract with the United States Department of Energy (DOE). SDG&E was the successful bidder for the Elk Hills Naval Petroleum Reserve (Elk Hills gas) with a bid of $2.6470 per MMBtu for 55,500 MMBtu per day. With the addition of the transportation cost to SDG&E the total cost to SDG&E was $2.8600 per MMBtu. The contract with DOE provided the purchase of Elk Hills natural gas for the period September 1, 1988 through December 31, 1988 on a binding delivery basis.

Table 1 sets forth a comparison between the Elk Hills gas and the cost of noncore gas from Southern California Gas Company (SoCal).

TABLE 1
Elk Hills -- SoCal Noncore

| MONTH | ELK HILLS VOLUME MMBTU (1) | ELK HILLS COST $/MMBTU (2) | ELK HILLS COST @ SDG&E (3) | SOCAL NONCORE @ SDG&E (4) | DIFFERENCE $ [(3)-(4)]*(1) (5) |
|---|---|---|---|---|---|
| Sept 88 | 1,670,658 | 2.6470 | 2.8600 | 2.6090 | 419,335 |
| Oct 88 | 2,090,230 | 2.6470 | 2.8600 | 2.5846 | 575,649 |
| Nov 88 | 1,766,831 | 2.6470 | 2.8600 | 2.5846 | 486,585 |
| Dec 88 | 1,810,895 | 2.6470 | 2.8600 | 2.5846 | 498,720 |
| TOTAL | | | | | $1,980,290 |

The total difference set forth in Table 1 is the amount that DRA recommends be disallowed.

Standard of Review

SDG&E and DRA disagree on the appropriate standard of review of reasonableness of gas contracts. SDG&E interprets D.86-12-010 and 89-04-080 as establishing standards whereby the Commission fairly assesses the reasonableness of utility energy operations and expenses by reviewing the construction of the gas portfolio and not reviewing each contract that, combined, make up the portfolio. SDG&E raised the issue of whether the premium paid for the Elk Hills gas should be considered in isolation, or whether the Commission should judge the Elk Hills contract as part of a portfolio, and weigh that portfolio against other portfolio options. SDG&E states that the company had 300 different contracts for gas during the review period. SDG&E interprets past Commission decisions as giving guidance to evaluate gas supply portfolios for reasonableness rather than review each contract in isolation.

DRA argues that by these same decisions, the Commission affirmed its right to examine the reasonableness of individual contracts which make up a particular gas utility company's core portfolio. In its Concurrent Opening Brief (p.3), DRA cites the Commission stating:

> "We expect utilities to demonstrate least cost purchasing practices, given the need for supply

> security. We reiterate our view that a well-managed portfolio will balance supply and cost considerations, and will provide a menu of supply arrangements with differing price, contract length, and other terms." (D.89-04-080, at p. 4, emphasis added.)

DRA argues that its review in this case has been a portfolio review, but that such a review does not preclude it from examining individual contracts in a reasonableness review. In addition, DRA finds that the Elk Hills contract merits attention as it "made up 34 percent of SDG&E's core portfolio during the months of September 1988 through December 1988." (Concurrent Reply Brief of DRA, p. 3.) SDG&E disputes that this percentage is relevant, noting that the Elk Hills contract totaled approximately ten percent of the SDG&E core purchases during the record period, and in that context only ten percent of the purchases were higher priced, meriting this higher price due to the firm deliverability of the gas.

The adopted guidelines for core procurement contained in D.89-04-080 state "[the Commission's] current and longstanding standards of review for reasonableness proceedings shall continue to apply." (D.89-04-080, Appendix A, p. 1.) We agree with DRA that the Commission may review individual contracts and is not limited only to reviewing aggregate supply portfolios. Individual contract review is necessary to establish the supply balance and cost considerations contained in the portfolio. The terms, including price, of each contract that combine to form the portfolio must be evaluated to establish the reasonableness of the core portfolio.

DRA is concerned that a premium is being paid for the Elk Hills gas. DRA contends that although the Elk Hills supply could reduce the risk of supply problems, the price that is being paid for this gas is not at market-based prices. When SDG&E's witness, Joseph P. O'Brien, was asked if there should be a premium paid for

the Elk Hills gas, his response was that it depends on the circumstances. (SDG&E/O'Brien, 6 R.T. pp. 387-388.) DRA does not believe that the circumstances SDG&E faced when it bid for the Elk Hills gas in August of 1988 warranted the premium that SDG&E paid for this supply. Instead of allowing "a little bit of latitude above perhaps what you might think is exactly your major competitor's bid" to make sure that you get the gas, SDG&E ended up paying significantly more for the gas when compared to the market realities at the time. (SDG&E/O'Brien, 6 R.T. p. 387; DRA, Ex. 25, pp. 2-10 to 2-11.)

SDG&E contends that the Elk Hills gas represents a firm supply from an intrastate source. SDG&E believes it submitted a bid sufficient to secure the contract on reasonable terms "given additional certainty of supply and the lack of other less costly, alternatives of comparable quality." With regard to the need for paying a premium for gas, SDG&E remarks that "[a]lthough it is a utility's responsibility to obtain secure gas supplies for its core at the lowest possible cost, a utility may have to pay a higher-than-average price on a given contract to gain an adequately secure supply." (Concurrent Opening Brief of SDG&E, p. 16 and 36.)

Both parties acknowledge the important balance between supply security risk and price security risk articulated by the Commission in D.86-12-010 (O'Brien, SDG&E, R.T. pp. 345-347:12-7; Macedo, DRA, R.T. pp. 290-294:11-16):

> "Utilities shall undertake to procure for their core procurement customers a supply portfolio which reasonably results in certainty of supply availability to serve core peak requirements, price security greater than can be achieved by relying totally on spot or other market price sensitive supply sources, and which attains these objectives at the lowest possible cost. The core portfolio should generally contain some percentage of spot or short-term market responsive supplies." (p. 84.)

The parties do not agree that in this case the payment of such a premium was appropriate.

The experience of this case raises the concern once again that perhaps more specific procurement guidelines are needed. The Commission regards the core procurement guidelines adopted in D.89-04-080 as only broad guidelines, recognizing that "[a]lthough we invited proposals for more specific guidelines, no party has proposed anything more specific than policy statements." (Id., p. 4.) Absent more specific guidance from the Commission, we agree with SDG&E that the need for a premium is dependent on the market conditions then prevalent. In this case, we agree with SDG&E that a gas premium was appropriate, given the supply security risks SDG&E anticipated.

Supply and Capacity Curtailment Outlook

Integral to the parties' positions on the reasonableness of the Elk Hills gas purchase is the security of the supply options available to SDG&E as was known, or should have been known, at the time the choice to procure Elk Hills gas by bid from the DOE was made. SDG&E submitted its bid August 4, 1988. The Commission implemented its restructured gas regulation on May 1, 1988.

Under the new regulatory framework, SDG&E had three alternative options for procuring gas for its core: service from SoCal's core portfolio (core-election), service from SoCal's noncore portfolio, or self-procurement. Only two of these options provided firm sources of supply, core-election and self-procurement. SDG&E chose self-procurement, stating that it "entered into the Elk Hills contract to stabilize and secure its core gas supply that was threatened by tumultuous events in the gas market during the summer of 1988." (Concurrent Opening Brief of SDG&E, p. 26.) SDG&E believed core-elect, and the one-year commitment it required, a more expensive option than self-procurement (Id., p. 44), a position not disputed in the record by DRA. Among the "tumultuous events" to which SDG&E refers were

changes on the El Paso Natural Gas Company (El Paso) pipeline and SoCal's treatment of SDG&E core storage.

El Paso Pipeline Concerns

SDG&E noted that in the last weeks of July the rate structure for the El Paso system had changed significantly, causing confusion as to the cost of gas over the system, and the gas liquids credits attributed to producers. Because of these events, SDG&E expected the gas price over the El Paso system to rise.

Further, El Paso had recently reduced the amount of gas it was able to call on to serve its potential system sales requirements. SDG&E asserts that prior to August 4th, SDG&E experienced curtailment of noncore supplies in part due to maintenance and repair outages on the El Paso system. The interruption in supplies from El Paso caused supply difficulties for both SDG&E and SoCal noncore. SDG&E also states that the late summer outages on El Paso caused SDG&E management to conclude that such outages might continue in the winter season, when the potential effect on SDG&E's core reserves would be more severe. SDG&E felt that reliability of interstate supplies was uncertain. The Elk Hills gas would protect SDG&E core storage volumes against its expected interstate and intrastate curtailments.

In this environment, SDG&E argues, the Elk Hills gas was an important part of the SDG&E supply portfolio, allowing SDG&E to get adequate volumes into storage in September and October and avoid large storage withdrawals in November and December.

DRA does not believe that SDG&E's rationale of purchasing Elk Hills gas due to concerns over a winter supply curtailment justifies the amount bid. DRA stated that two months of the contract (September and October) were during the SDG&E summer season when gas is typically plentiful and competitively priced. The SDG&E expectation of El Paso disruptions continuing into the winter was not well founded, DRA argues, because outages due to maintenance are scheduled for summer when demand is low in order to

get the system in good shape for the higher winter demand. (Concurrent Opening Brief of DRA, p. 9.) Further, SDG&E is tied for first in the El Paso interruptable queue. The parties agree that in the summer of 1988, El Paso maintenance included actual pipe replacement in May, June, and July. The parties further agree that every effort is made to do maintenance during the summer season when demand is typically lower. (SDG&E/O'Brien, R.T. p. 86; Concurrent Opening Brief of DRA, pp. 9, 10.)

DRA argues that SDG&E had reliable alternative gas supplies available at lower cost to meet its storage gas needs in September and October and therefore did not need to purchase Elk Hills gas at a premium. DRA states that SDG&E should have known that:

> "maintenance on the El Paso pipeline during the summer of 1988 was only temporary and that the pipeline could be expected to be fully operational during the winter months... that for gas heating purposes, gas is available in September and October, and furthermore prices tend to be lower in September and October than in the peak winter months.... SDG&E was tied for first place on the interruptable queue for El Paso, and was eleventh on Transwestern's interruptable queue.... Taking all this into consideration, SDG&E had a strong probability of getting gas to SoCal's system for either injection or to serve its customers during the period the Elk Hills contract was in effect." (Concurrent Reply Brief of DRA, p. 7.)

We agree with DRA that SDG&E's concern over continued maintenance on the El Paso system in the winter was unfounded. We also agree with SDG&E that the changes in the rate structure, liquids credits, and the amount of gas which El Paso was able to call on to serve its potential system sales warranted concern about the reliability of service over the El Paso interstate system. SoCal and SDG&E depend on system sales gas when the transportation gas they contract for is not delivered. The rate structure and

liquids credits uncertainty would impact both El Paso system sales gas and El Paso transportation gas.

SoCal's Treatment of
SDG&E Core Storage

SDG&E states that SoCal revised downward its plans for core storage from entering the winter season with 80 to 90 Bcf of gas in storage to 61 Bcf. Coupled with SDG&E's concerns over interstate dependability, SDG&E felt its core supply security compromised. SDG&E's core storage was further compromised, it states, by SoCal's reaction to the capacity curtailments on the El Paso system. SoCal reacted in part by withdrawing gas from its storage reserve, which in turn prevented SDG&E from injecting gas for its core customers in late July and early August.

This curtailment of SDG&E core storage created supply security concerns for SDG&E in the event of SoCal capacity or supply curtailments.

The Prospect of Capacity Curtailments

A capacity curtailment results from a capacity shortage, defined as

> "a condition when, in the Utility's judgement, there exists a restriction or limitation on Utility transmission or distribution pipelines necessary for the acceptance, transportation or subsequent redelivery of gas resulting in the Utility being unable to meet its operational, contractual or gas customers' requirements." (SoCal Rule Number 23, Supplement C.)

In the event of a capacity curtailment by SoCal, the utility would trim transportation of gas through its system according to its priority schedule. SoCal assigned a low priority to SDG&E gas destined for storage. (Concurrent Opening Brief of SDG&E, p. 28.) According to SDG&E, if SDG&E bought noncore gas from SoCal destined for injection into storage to serve SDG&E's core, it would likely be curtailed in the event of a capacity curtailment due to its low priority. SDG&E states that its actual

experience with SoCal during capacity curtailments would indicate Elk Hills gas is more firm than out-of-state sources and would be treated differently by SoCal relative to SDG&E noncore purchases from SoCal:

> "In the past (as now), SoCal had allowed SDG&E to fill its storage as long as SoCal's ability to serve its customers was not affected, regardless of capacity or supply curtailment situations." (Emphasis added, Reply Brief of SDG&E, p. 12.)

SoCal noncore gas destined directly for SDG&E's core, on the other hand, would be unlikely to be curtailed during a capacity curtailment. This gas would assume a priority equal to SoCal's core customers. The same would be true for any third party gas, such as Elk Hills gas, acquired by SDG&E and transported directly to the burner tip. This gas would also assume a priority equal to that of SoCal's core customers.

DRA argues that in a capacity curtailment situation, the in-state Elk Hills gas would not have been any more firm than an out-of-state source of supply since SoCal's Rule Number 23 does not distinguish between in-state and out-of-state sources. (Concurrent Opening Brief of DRA, p. 8.) SDG&E's core customers' priority is equivalent to SoCal's core customers' priority under a capacity curtailment.

The equal treatment SDG&E's core receives with respect to SoCal core under a capacity curtailment negates SDG&E's argument that Elk Hills gas protected its core in the event of a capacity curtailment. SDG&E's actual experience with SoCal capacity curtailment of core storage gas indicates SDG&E may have derived some advantage for its ratepayers in purchasing Elk Hills gas. We believe there may be a possible inconsistency between the way SDG&E claims SoCal treats SDG&E storage injection of gas from an in-state supply source in the event of a capacity curtailment and Rule 23.

The Prospect of a Supply Curtailment

A supply curtailment results from a supply shortage, defined as:

> "a condition when, in the Utility's judgement, the Utility has a deficiency of gas supply available to meet its operational, contractual or sales customers' requirements." (SoCal Rule Number 23, Supplement C.)

A SoCal supply curtailment would affect SDG&E when SDG&E is receiving service from SoCal's noncore portfolio. In the event of a supply curtailment when SDG&E is receiving service from SoCal's noncore portfolio, SDG&E could serve its core by buying third party gas and transporting it over the SoCal system to the core. Alternatively, SDG&E could use storage gas to serve its core.

SDG&E argues that because of interstate pipeline reliability concerns, gas procured from a third party dependent on interstate pipelines for transportation was not preferred. Because of the low priority assigned SDG&E storage gas[1] in the event of a capacity curtailment, SDG&E was not comfortable relying on storage gas in the event of a SoCal supply curtailment. SDG&E argues that the Elk Hills gas provided the best mechanism to mitigate supply risks as they were known on August 1, 1988. (Concurrent Opening Brief of SDG&E, pp. 25-33.)

DRA notes that a supply curtailment would not affect SDG&E's ability to serve its core customer loads as long as SDG&E could get gas supplies from sources other than SoCal to SoCal's system, or has adequate storage volumes to withdraw. DRA argues

1 We do not understand why SDG&E believed a low priority was assigned to SDG&E core storage. Nor do we understand why SDG&E chose not to bring this situation before the Commission, if it was indeed a problem, as DRA suggests. (Concurrent Opening Brief of the DRA, p. 9.)

that SDG&E had reliable alternative gas supplies and does not agree with SDG&E's expectations of interstate reliability concerns. Therefore, DRA does not believe that SDG&E's purchase of the Elk Hills gas at $2.6460 per MMBtu was justified. (Concurrent Opening Brief of DRA, pp. 5-7, 15.)

We agree with SDG&E that Elk Hills gas was the best mechanism to mitigate the supply curtailment risks prevalent at the time SDG&E bid for the contract, especially in light of the uncertainty of interstate supply reliability. Elk Hills gas provided SDG&E core protection against supply curtailments as it was an in-state source not subject to interstate curtailments, and was not best-efforts delivery but rather was based on binding delivery.

Elk Hills Gas as Leverage Over SoCal

SDG&E also claims that the Elk Hills supply provided leverage over SoCal in the event that SoCal curtailed SDG&E storage injections. In their reply brief, SDG&E states:

> "If SoCal refused to fill SDG&E's storage with the Elk Hills gas SDG&E would be no worse off, whether it allowed SoCal to control the gas or whether it diverted the gas outside of SoCal's system. On the other hand, SoCal would be substantially worse off if SDG&E diverted the gas because SoCal would lose a gas supply that it could not replace with other intrastate or interstate supplies, i.e. SoCal would lose the benefit of this incremental capacity resource." (Reply Brief of SDG&E, p. 13.)

DRA states that SDG&E's leverage idea has no basis. DRA concludes that since SDG&E would have been no worse off than it was before incurring the expense of Elk Hills gas, "any supposed 'leverage' was purely imaginary." (Concurrent Opening Brief, p. 9.) Further, DRA notes that SDG&E did not present any corroborating evidence to back up its leverage claim. DRA argues that:

> "If one examines the logic of what SDG&E was trying to do ('either you give me what I want

> or I will keep something away from you that you want') by serving an EOR customer that SoCal could not serve, SoCal simply had nothing to lose." (SDG&E/O'Brien, 6 R.T. p. 407; Concurrent Reply Brief of DRA, p. 6.)

We do not find the SDG&E leverage argument persuasive. It is not clear that SoCal would consider SDG&E's action with regard to use or sale of Elk Hills gas in planning for its system needs.

Deriving the Appropriate
<u>Price for the Elk Hills Purchase</u>

SDG&E states that in developing the appropriate price for Elk Hills gas, it characterized the gas as firm gas on a binding delivery basis, not comparable to interruptable, best-efforts gas. SDG&E's routine pricing policy for multi-month agreements was to seek opportunities which were below the price of spot gas. In this instance, given the secure nature of the Elk Hills supply, SDG&E did not feel that standard to be appropriate.

In Exhibit 28, p. 3, SDG&E describes the preparation of the Elk Hills bid price.

> "In arriving at the specific $2.647/MMBtu bid price, SDG&E first of all examined the SoCal core-elect alternate price as it was expected to be once an adjustment was made for any under-collections. SDG&E also looked at the expected non-core market price for both SoCal and its own WACOG portfolio during this time. Based upon recent developments in the month of July, these prices were also expected to be quite high in the coming period. The forecast at the time called for interruptable gas prices of $2.34, $2.38, $2.65, and $2.67 per MMBtu over the four months associated with the bid. SDG&E examined the input of a number of employees who were attuned to the gas market at that time to determine what they: (1) expected gas prices would be over the upcoming period; and (2) would result in a winning price for the Elk Hills gas after considering how other potential bidders might value the gas."

According to Exhibit 27, SDG&E also consulted spot gas forecasts. SDG&E includes the spot gas forecast in use prior to the Elk Hills bid, which includes only the months of September and October as relevant to the Elk Hills contract. September and October spot gas prices were forecast at low, medium, and high levels, ranging from $1.50 and $1.55 respectively on the low end for the two months, to $1.95 and $2.00 on the high end for those months.

SDG&E states that its aggressive bid posture was based on "a very thorough estimate in terms of what was required to win the bid." (SDG&E/O'Brien, 4 R.T. p. 148.) This "thorough estimate" apparently was derived by polling 7 or 8 different SDG&E employees who were responsible for coming up with a bid price for the Elk Hills gas. These people were responsible for determining what the expected gas prices would be over the winter 1988 to 1989 time period, and for determining what a winning bid price for the Elk Hills gas would be. (SDG&E/O'Brien, 4 R.T. pp. 164-165.) Each of the seven or eight individuals submitted their own perceived bid for the Elk Hills gas to this group to review. Some of the bids were lower than SDG&E's actual bid of $2.647. According to O'Brien, this group then came to a consensus, and decided to submit a bid of $2.647 for the Elk Hills gas. (SDG&E/O'Brien, 4 R.T. pp. 169-172; DRA, Ex. 28, p. 3.)

Before each person in the seven or eight member group submitted their own perceived bid, this group discussed the various analyses that they had done, and what they thought would be reasonable prices to pay for the Elk Hills gas. (SDG&E/O'Brien, 4 R.T. p. 169.) It is unclear, however, what forecasts of gas prices SDG&E used in coming up with a bid for the Elk Hills gas.

DRA believes that a disallowance is warranted for the Elk Hills gas purchase because SDG&E bid too high for this gas without any adequate justification for doing so. SDG&E did not have any

compelling reason to "aggressively bid" for the Elk Hills gas. Yet, SDG&E paid a handsome premium for this gas.

DRA notes the action taken by other bidders for the Elk Hills gas, stating that such information is useful in evaluating the reasonableness of the action taken by SDG&E in the same market environment. SDG&E's bid of $2.647 per MMBtu for 55,500 MMBtu per day of gas from Elk Hills was the highest bid submitted to DOE. (DRA, Ex. 29.) According to SDG&E, the bid submitted by SDG&E "was set to win the contract and was reasonable in light of market conditions at the time and expectations of behavior by other competitors for the supply." (SDG&E, Ex. 35, p. JPO-2.) However, the behavior of the other competitors, operating in the same market environment, bidding for this gas supply contrasted sharply with that of SDG&E. The second highest bid was that of SoCal, who bid $2.5087 for this same amount of gas. (DRA, Ex. 29.) Thus, on a daily basis, SDG&E was paying $8,930 more than what SoCal was willing to pay for the same gas. Over the term of the contract, SDG&E would have paid approximately $1.089 million more than what SoCal was willing to pay. The third highest bidder for the Elk Hills gas was Chevron U.S.A., Inc. who bid $2.2560 per MMBtu. (DRA, Ex. 29.) DRA argues that although these facts were not known to SDG&E at the time of the blind bid, they do indicate what value other parties ascribed to the Elk Hills gas supply at the same time that SDG&E was constructing what it regards an appropriate value for the gas.

At the hearings, it was disclosed that a number of different forecasts were used by SDG&E in coming up with a bid for the Elk Hills gas. Apparently, the primary forecast that was relied on by O'Brien was the forecast contained in Exhibit 28 at page 3 of $2.34, $2.38, $2.65, and $2.67 per MMBtu for September through December of 1988. This exhibit was prepared by O'Brien in response to a DRA data request. (SDG&E/O'Brien, 4 R.T. pp. 153, 156, 159; 6 R.T. pp. 382-383.)

SDG&E argues that DRA's proposed disallowance would discourage utilities from entering into contracts necessary to assure core supply under adverse conditions, since such contracts typically include prices that appear high by comparison to spot prices if the adverse conditions do not occur.

SDG&E became a noncore customer of SoCal. SoCal had no obligation to provide a secure gas supply to SDG&E's core customers unless SDG&E elected into SoCal's core portfolio for those customers. SDG&E states that it concluded it could likely provide core security through self-procurement less expensively than opting into SoCal's undercollected core portfolio.

SDG&E knew that because the Elk Hills gas was provided on a firm delivery basis, rather than best-efforts delivery, this supply could be used to fulfill the requirement for core security if no other firm delivery supplies appeared available in the winter. SDG&E decided to self-procure Elk Hills gas for its core instead of opting into SoCal's core-elect.

SDG&E argues that a portfolio must contain both market-responsive measures to take advantage of favorable market conditions and defensive measures; i.e., contracts with greater supply certainty even though priced above the expected prices of spot gas, to prepare for adverse conditions. The defensive measures SDG&E took to prepare for adverse conditions were to enter into the the firm delivery Elk Hills contract and to maintain its gas storage in SoCal's system.

In retrospect it may well appear that SDG&E paid a premium for the Elk Hills gas. In determining whether the actions of SDG&E were reasonable we must look at all factors which led to the decision at the time the decision was made.

The dispute in this case over the reasonableness of the SDG&E Elk Hills contract centers around two questions. The first is whether it was appropriate to pursue Elk Hills gas in order to be insulated from capacity and supply curtailments. We have

evaluated whether the need to bid aggressively was credible, examining whether uncertainty over a reliable gas supply from other sources existed. In addition, we assured ourselves that the Elk Hills supply actually provided the security which SDG&E sought.

The second central question is whether the price which SDG&E submitted for the Elk Hills gas was reasonable and prudent given the information SDG&E had available at the time. Although we do not regard the process SDG&E used in arriving at the Elk Hills bid price particularly robust, we do not find the resulting bid price unreasonable.

## Findings of Fact

1. DRA reviewed SDG&E's gas supply and storage management, gas system, and operations, gas procurement policy and practices, and gas operating plans for the record period May 1, 1988 to July 31, 1989.

2. DRA found SDG&E's energy operations and expenses to be reasonable for the record period except for the purchase of natural gas under a contract with DOE.

3. SDG&E was the successful bidder for the Elk Hills gas with a bid of $2.6470 per MMBtu for 55,500 MMBtu per day.

4. With the addition of the transportation cost to SDG&E the total cost to SDG&E was $2.8600 per MMBtu delivered.

5. At the time the decision was made to bid for the Elk Hills gas, the primary concern of SDG&E was that it have sufficient gas available to serve its core customers during the winter should there be a supply or capacity curtailment.

6. DRA recommends a disallowance of $1,980,290 which is the difference between what SDG&E would have paid for SoCal noncore gas and what it paid for the Elk Hills gas.

## Conclusions of Law

1. SDG&E's energy operations and expenses for the record period were reasonable.

2. The recommendation of DRA set forth in Finding of Fact 6 should be rejected.

3. This proceeding should be closed.

**O R D E R**

IT IS ORDERED that Application 89-09-031 is closed.

This order is effective today.

Dated November 9, 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

Commissioner Stanley W. Hulett, being necessarily absent, did not participate.

I CERTIFY THAT THIS DECISION WAS APPROVED BY THE ABOVE COMMISSIONERS TODAY

NEAL J. SHULMAN, Executive Director