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Decision 98-08-038 August 6, 1998

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric  
Company to Establish a Permanent Gas  
Procurement Performance-Based Ratemaking  
Mechanism.

Application 97-09-049  
(Filed September 30, 1997)

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## O P I N I O N

### 1. Summary

The Commission approves a settlement agreement reached by three of the four active parties in this proceeding. San Diego Gas & Electric Company (SDG&E) is authorized to implement a modified performance-based ratemaking (PBR) mechanism for its gas procurement activities in place of its currently effective gas procurement PBR experiment. SDG&E's gas purchasing performance will be measured against a single market price benchmark. "Savings" which result when the utility's actual gas costs fall below the benchmark will be shared equally between customers and shareholders. If gas procurement costs exceed the benchmark plus a 2% deadband, ratepayers will pay for 25% of such "losses" and shareholders will pay 75%.

The Commission finds that the settlement agreement's provisions for monitoring and evaluating the PBR mechanism would be enhanced by certain additional reporting requirements. Provision is made for the settling parties to accept or reject these requirements or to request other relief.

The settlement agreement establishes a new advice letter procedure for resolving PBR rewards and penalties. It also provides for a compromise resolution of a disputed reward for the fourth year of SDG&E's current gas procurement PBR mechanism. These components of the settlement agreement are approved.

While most of the issues in this proceeding are resolved by this decision, the proceeding shall remain open pending disposition of the Commission's proposed enhancements to the settlement agreement's monitoring and evaluation program.

## **2. Background**

### **2.1 Current Gas Procurement PBR Mechanism**

On June 23, 1993, by Decision (D.) 93-06-092, the Commission approved a proposal by SDG&E for an experimental gas procurement PBR mechanism. The experiment was implemented on August 1, 1993. It replaced the traditional regulatory approach whereby SDG&E recovered gas procurement costs on a dollar-for-dollar basis, subject to after-the-fact review of the reasonableness, and potential disallowance, of those costs.

In approving the experiment, the Commission noted the criticism that the traditional approach of reasonableness review may hamper the utility's productive efficiency since the utility does not share in the gains from successful innovations but could be saddled with all the losses from unsuccessful innovations. With the objective of giving SDG&E positive incentives to pursue low-cost gas purchases and deliveries, D.93-06-092 eliminated reasonableness review of SDG&E's gas procurement costs. In its place, the Commission provided for ratepayer and shareholder sharing of losses and savings relative to two market-based gas price benchmarks. Part A provides equal sharing of excess costs and savings as an incentive to minimize gas commodity costs within SDG&E's major supply markets. Part B provides incentives to lower total delivered costs of gas by allowing shareholders to earn 5% of savings relative to the benchmark.

The Commission's expectation was that ratepayer and shareholder interests would be aligned: SDG&E would see gains if it was successful in lowering gas costs for customers. However, despite this promise of an improvement over current regulation, the Commission emphasized that the mechanism was experimental in nature. Accordingly, the mechanism was adopted for a term of two years along with a provision that it could be left in

place into the third year. The Commission directed SDG&E to file an appropriate pleading to extend, make permanent, discontinue, or modify the experiment at the time a second annual report on the mechanism was due.

By D.95-04-051 and D.97-02-012, the Commission continued the experimental mechanism in effect beyond the initial two-year term. Among other things, D.97-02-012 directed SDG&E to file an application for a permanent gas procurement PBR. It also directed SDG&E to convene workshops before filing the application and directed interested parties to fully participate in such workshops. D.97-02-012 continued the experimental mechanism in effect (with modification to the Part B Benchmark) until issuance of a decision on the application.

## ***2.2 Overview of SDG&E's Original Proposal***

In this application SDG&E has proposed replacing the current PBR experiment with a permanent, rate cap mechanism for gas procurement. The central feature is a single, unbundled gas procurement rate which would be capped at 102% of a defined monthly California Border Index (CBI). The CBI is offered as a recognized market-based indicator of gas prices. The gas procurement rate would apply as the default rate for all core and non-core customers that choose to take gas procurement service from SDG&E. Subject only to the monthly CBI + 2% rate cap, SDG&E would be free to adjust the rate to any level on three days' notice.

Unlike other PBR mechanisms considered by the Commission, SDG&E's rate cap proposal did not include a revenue sharing provision. Revenues earned under the capped gas procurement rate would recover the commodity and variable transportation costs of natural gas supplies delivered into the Southern California Gas Company (SoCalGas) system; costs associated with gas futures

and derivatives trading related to gas procurement; and costs of gas storage other than core reliability storage. However, the utility brokerage fee, last adopted in D.97-04-082, would remain unbundled and would not come under the rate cap. SDG&E would also continue to separately recover above-market interstate pipeline capacity costs in the Core Interstate Transition Cost Surcharge (CITCS) as authorized by D.97-04-082, and the costs of storage for core reliability. SDG&E proposed several tariff schedule revisions to ease administration of the new rate and to streamline its current tariffs. The Purchased Gas Account (PGA), established to stabilize rates while allowing the rates to follow the market, would be eliminated with adoption of the rate cap.

### ***2.3 Procedural Background***

In accordance with D.97-02-012, SDG&E convened five workshops to gather input from intervenors prior to filing the application. While parties were not able to reach consensus on proposals by the application filing deadline, SDG&E states that progress was made towards that goal.

Protests to the application were filed by Utility Consumers' Action Network (UCAN), Enron Capital and Trade Resources (Enron), and the Office of Ratepayer Advocates (ORA). While taking issue with the rate cap proposal in several important substantive respects, the protestants generally supported SDG&E's procedural proposal to pursue settlement discussions before proceeding with evidentiary hearings.

ORA offered two counterproposals with its protest. Both alternatives reflect ORA's (and Enron's) position that SDG&E's proposal inappropriately favors shareholders in part because it allows continued separate CITCS treatment of above-market pipeline costs in conjunction with a rate cap approach. ORA's first alternative is a rate cap patterned after SDG&E's application but modified

by capping the gas procurement rate at CBI + 1% and by eliminating the CITCS. ORA's second alternative proposal retains CITCS treatment. It is based upon the current PBR mechanism but with Part B eliminated and no ratepayer sharing of losses. ORA believes its latter proposal is appropriate if the Commission prefers to maintain sharing and does not favor a change from the policy set forth in D.97-04-082 for the treatment of interstate pipeline costs.

A prehearing conference (PHC) was held on December 9, 1997 at which the Administrative Law Judge (ALJ) deferred setting a litigation schedule and provided further opportunity for settlement. At a second PHC held on February 5, 1998, SDG&E reported that following a series of settlement negotiations, the first of which was formally noticed as a settlement conference in accordance with Rule 51.1(b) of the Rules of Practice and Procedure (Rules), it had reached a settlement agreement with Enron and ORA. The ALJ directed the settling parties to file a motion for approval of the settlement on or before February 20, 1998 and to include a comparison exhibit identifying parties' positions to facilitate evaluation of the reasonableness of the settlement. Pursuant to Rule 51.4, the ALJ provided for the filing of comments within 30 days and the filing of replies to comments within 15 days thereafter.

In accordance with the adopted schedule, SDG&E, Enron, and ORA (the settling parties) filed a joint motion for approval of their settlement agreement. They propose a replacement gas procurement PBR mechanism which is based largely on ORA's alternative counterproposal to modify the current experimental mechanism by eliminating Part B. UCAN filed comments (which were docketed under the title *Opposition by Utility Consumers Action Network (UCAN) to Proposed Settlement*) on March 19, 1998. SDG&E and ORA filed joint reply comments (which were docketed under the title *Joint Response of San Diego Gas & Electric*

*Company (U 902-G) and Office of Ratepayer Advocates to Protest by Utility Consumer Action Network of Proposed Settlement)* on April 7, 1998.

SDG&E's application was filed and the first prehearing conference was held before January 1, 1998. Accordingly, pursuant to Rule 4(b)(2), this proceeding is not subject to the SB 960 rules and procedures set forth in Article 2.5 of the Rules.

### **3. Discussion**

#### **3.1 Need for Hearings and Briefing**

UCAN has no position on many aspects of the PBR mechanism proposed in the settlement agreement, and it states that the settlement agreement in part comports with concerns which it raised during settlement discussions. However, UCAN contests certain aspects of the settlement regarding monitoring and evaluation of the mechanism. Specifically, UCAN believes that the proposed monitoring and evaluation program is inadequate in several respects. Among other things, UCAN believes that evaluative criteria should be incorporated into the mechanism. UCAN recommends that the monitoring and evaluation component of the proposed PBR mechanism be modified to address its concerns.

Thus, at issue is a contested settlement as defined in the Commission's stipulation and settlement rules (Article 13.5 of the Rules, commencing with Rule 51). Rule 51.5 requires parties who contest a proposed settlement to specify in their comments the portions of the settlement they oppose, the legal basis of their opposition, and the factual issues that they contest. They should also indicate the extent of their planned participation at any hearing. If the contesting party asserts that a hearing is required by law, appropriate citation should be provided. Any failure of the party to file comments results in waiver by that party of all objections to the settlement. In addition to these general



requirements of the stipulation and settlement rules, the ALJ advised parties at the second PHC that in the absence of a request that evidentiary hearings be held, the matter would be submitted to the Commission without hearings or issuance of a proposed decision prior to the Commission's decision. (Tr. PHC-2, pp. 19-20.)

While UCAN has protected its right to contest the settlement by timely filing comments in accordance with Rules 51.4 and 51.5, it neither requests that hearings be held nor identifies disputed factual issues which would require hearings. Moreover, while Rule 51.6 (b) provides an opportunity for briefs on disputed legal issues, UCAN does not identify issues that would trigger this requirement either. Evidentiary hearings and briefing are unnecessary.

The record of this proceeding comprises the application and accompanying exhibits; the protests by filed Enron, ORA, and UCAN; the joint motion for approval of the settlement agreement; the settlement agreement itself; the comments by UCAN; and the joint reply comments of SDG&E and ORA. UCAN has raised policy issues regarding the appropriate monitoring and evaluation program, and this record provides an adequate and reasonable basis for resolving these contested monitoring and evaluation issues as well as the uncontested portions of the settlement agreement.

### ***3.2 Design of the Proposed Mechanism***

The settlement agreement provides for a replacement gas procurement PBR mechanism which is based on ORA's alternative proposal to use Part A of the current, experimental mechanism but incorporates a revised sharing provision. Details of this mechanism are set forth in Appendix A to this decision. A new procedure would be established for resolving annual PBR rewards and penalties, and monitoring and evaluation as ordered in D.93-06-092 would be

continued, subject to additional specified reporting requirements. The settling parties propose that the mechanism be adopted for an initial term of five years or until modified by the Commission.

Under the settlement proposal, SDG&E's gas purchasing performance would be measured each gas PBR year (August 1 through July 31) by comparing the utility's actual procurement costs for gas supplies against a single market price benchmark. The proposed benchmark reflects gas production basin indices as well as a California border index. If the utility's actual gas costs fall below the benchmark, the savings would be shared equally between customers and shareholders. If actual procurement costs exceed the benchmark but are within a defined 2% deadband, ratepayers would pay all of such costs. If actual procurement costs exceed the benchmark plus the 2% deadband, ratepayers would pay 25% of such losses and shareholders would pay 75%. By the start of each gas PBR year, SDG&E would be required to identify for operational purposes its core storage inventory target level for November and the minimum inventory level for the end of January. The CITCS and the PGA would be retained.

Compared to SDG&E's original rate cap proposal, the settlement proposal for a market-based benchmark and retention of the CITCS treatment represents an evolutionary and more conservative approach to PBR design. In light of the protestants' objections to SDG&E's original proposal to retain CITCS treatment in combination with a rate cap approach, the lack of a sharing provision in SDG&E's proposal, and other deficiencies asserted in the protests, the settlement provides a fair and reasonable compromise of these disputed issues. Among other things it reflects ORA's position that Part B of the current mechanism has generated substantial shareholder benefits and is outdated. Although ORA had proposed no sharing of losses, we are satisfied that the provision for 25% ratepayer sharing

of losses above the 2% deadband is reasonable. We expect that this sharing provision will create a strong incentive for SDG&E to avoid such losses, which in turn should align shareholder and ratepayer interests. The settlement also resolves the parties' concerns that SDG&E's original proposal had potentially anticompetitive effects, and it eliminates the parties' concerns regarding SDG&E's original plan to outsource the gas procurement functions. We note that the settlement agreement's proposed PBR design is uncontested.

Significantly, all parties appear to agree that PBR should be continued for SDG&E's gas procurement, and there are no suggestions that we return to reasonableness review of gas procurement. ORA takes the position that "the experimental gas procurement PBR mechanism has provided appropriate incentives for SDG&E to minimize its gas procurement costs and has served to align ratepayer and shareholder interests in an appropriate and beneficial manner." (ORA protest, p. 2.) As SDG&E noted in the application, a series of evaluation reports by ORA (and its predecessor, the Division of Ratepayer Advocates), Vantage Consulting (hired by the former Commission Advisory and Compliance Division), and SDG&E found that the program had worked well in its early years, had met the Commission's objectives of competitively priced and reliable gas service, and represented an improvement over the traditional reasonableness review.<sup>1</sup>

Based upon the foregoing, we find that continuing PBR regulation for SDG&E's gas procurement activity is in the public interest, and that the program offered by the settling parties is a reasonable next step to take in continuing the PBR approach to regulation.

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<sup>1</sup> We noted these favorable assessments in D.95-04-051 and D.97-02-012.

### ***3.3 Resolution of Rewards and Penalties***

D.93-06-092 provided that the resolution of gas procurement rewards and penalties would occur in the reasonableness phase of annual Energy Cost Adjustment Clause (ECAC) proceedings. The settling parties believe that this provision has not worked out as smoothly as it should have, and has resulted in considerable delay between the intended incentive and the actual resolution of the reward or penalty. They point out that the annual results and shareholder rewards and penalties for Years 2, 3, and 4 of the experimental mechanism have not yet been approved or disapproved by the Commission. Moreover, they note that the Commission has recently eliminated the ECAC mechanism, making this annual forum unavailable.

Accordingly, the settlement agreement provides a new procedure to determine SDG&E's annual PBR results and the associated reward or penalty. If SDG&E and ORA agree on the annual reward or penalty in their respective annual evaluation reports, SDG&E would file an advice letter to give effect to such reward or penalty. If SDG&E and ORA differ on the appropriate reward or penalty, they would meet and confer in an attempt to resolve the dispute. If the dispute is resolved in the meet and confer process, an advice letter reflecting the dispute's resolution would then be filed. Where the meet and confer process is not successful in resolving such a dispute, SDG&E would file an application, or, with ORA's consent, a motion or petition, to resolve the disputed amounts. The settling parties believe that this procedure protects the interests of ratepayers and shareholders and that it is more efficient than the formal procedure provided in D.93-06-092.

We concur that the proposed advice letter process is a better approach to timely and efficient disposition of PBR rewards and penalties, especially in light of the elimination of the traditional ECAC proceedings. The provision for

addressing potential disputes between SDG&E and ORA regarding the annual calculation of rewards and penalties should help to eliminate the delays that have occurred under the current mechanism. Although historically only SDG&E and ORA have addressed the annual determination of rewards and penalties, the provision for advice letter filings gives all interested parties reasonable opportunity to register their concerns and have them resolved by the Commission.

### ***3.4 Rewards and Penalties Under the Current Mechanism***

The settling parties propose that the above-described advice letter procedure be used to resolve rewards and penalties which are still pending from the current gas procurement PBR mechanism. We find reasonable and approve this proposal as an appropriate solution to the procedural problems that have been identified. We will authorize SDG&E to file advice letters to resolve pending rewards and penalties for the second through fifth years of the experiment.

ORA and SDG&E have agreed that SDG&E is entitled to rewards of \$2,062,356 and \$212,533 for Year 2 and Year 3, respectively, and they note that no party has registered opposition to these rewards. The settling parties have further agreed upon a compromise resolution of a \$981,493 dispute concerning the Year 4 reward. Specifically, SDG&E had requested a shareholder reward of \$7,309,125, while ORA recommended a Year 4 reward of \$6,327,632 based upon its position that shared savings should be reduced by the amount of certain load balancing costs paid by SDG&E's customers. The settlement agreement provides for a Year 4 reward of \$7.0 million. It further provides for no adjustments to the Year 5 reward or penalty, or to rewards and penalties under the new gas procurement PBR mechanism, for the costs paid by SDG&E ratepayers for load

balancing on the SoCalGas system. We accept these agreements as reasonable compromises of the litigation positions of SDG&E and ORA.

Rule 51.1(a) provides that the resolution of material issues by settlement "shall be limited to the issues in that proceeding and shall not extend to substantive issues which may come before the Commission in other or future proceedings." Neither the procedural proposal to resolve pending rewards and penalties by advice letter nor the substantive proposals to resolve the Year 2 and Year 3 rewards and the contested Year 4 reward were raised in SDG&E's application. These proposals are technically beyond the scope of this proceeding and would properly be addressed in Application (A.) 92-10-017, the proceeding in which the current experiment was adopted. However, the parties in this proceeding are essentially the same as those who addressed gas procurement PBR issues in A.92-10-017. We find that interested parties have received notice of the proposed disposition of rewards and penalties under the current gas procurement PBR mechanism. Pursuant to Rule 87, we waive Rule 51.1(a) to the extent necessary for consideration of the proposals in this proceeding.

### ***3.5 Monitoring and Evaluation***

#### **3.5.1 The Settlement Agreement Proposal**

The settling parties propose a monitoring and evaluation program which is largely based on the current program established by D.93-06-092. SDG&E would retain the obligations to provide information that were set forth in D.93-06-092. The settlement also proposes the following minimum requirements:

- a. SDG&E shall submit a monthly gas procurement report to ORA and the Energy Division 60 days after the end of each monthly reporting period. This report will contain calculations for the gas procurement PBR benchmark and shareholder rewards or penalties. The report will be in the

format shown in Table G-1 (Schedule A) and Table G-2 (Schedule B), attached to this decision as Appendix B.

- b. SDG&E shall file and serve an annual gas procurement report 90 days after the completion of each Gas PBR year (August 1 through July 31). Each report will include results of the mechanism for that year, the calculation of shareholder rewards or penalties, and an explanation of the variance between actual and benchmark costs.
- c. SDG&E shall continue to submit to ORA all currently required confidential reports related to gas procurement. This information shall be submitted pursuant to Public Utilities Code Section 583 and General Order 66. SDG&E's monthly and annual reports contain aggregated summary level data and will be public document.
- d. After the completion of each Gas PBR year, ORA shall collect and perform an evaluation of data based upon findings from its audit of SDG&E's gas procurement costs. ORA shall file a report with its results and recommendations 75 days after SDG&E's annual report is filed.

SDG&E has operated under a gas procurement PBR for five years, and it is not necessary to cast the modified gas procurement PBR as an experiment. This impacts the monitoring and evaluation program, which was originally established to address the Commission's concern that it must be able to "halt the experiment promptly if goes awry." (D.93-06-092, 50 CPUC2d 185, 191.) At the same time, it remains important to periodically evaluate whether the mechanism is successful in meeting the overarching objective of ensuring that SDG&E continues to provide reliable gas supply at competitive rates and with measurable benefits to customers. Although SDG&E had initially proposed that evaluations be undertaken at the end of the second and fifth years, and ORA had similarly proposed evaluations at the end of the second and fourth years, we

agree that annual reporting should occur. With minor modifications discussed below, we find that the proposed monitoring and evaluation plan is a reasonable and valuable component of the proposed PBR program. It fulfills the need for periodic evaluations of whether the program is performing successfully.

### **3.5.2 Evaluation Criteria**

UCAN contends that evaluative criteria are essential tools by which the Commission and the parties can determine whether the outcomes of the PBR mechanism are consistent with the objectives of the program. UCAN faults the settlement agreement for lacking such criteria. As indicated before, we seek ongoing assurance that the gas procurement mechanism continues to meet its objective, i.e., that SDG&E continues to provide its customers with a reliable gas supply at competitive rates and with measurable benefits to ratepayers. That should be the principal evaluation criterion. We are not persuaded that it is necessary to adopt a more explicit and detailed list of evaluation criteria at this time. Nevertheless, we take this opportunity to comment on UCAN's specific criteria, and we incorporate UCAN's suggestions, in part, in the enhanced reporting requirements discussed in the following section.

In D.94-08-023 dated August 3, 1994, the Commission identified four objectives for reforming traditional regulation of SDG&E's base rates. At the time, base rates were set in triennial general rate cases (GRCs). The Commission's reform objectives were (1) to provide a greater incentive than the traditional GRC approach provided for the utility to reduce rates; (2) to provide a more rational set of incentives than traditional rate base ratemaking and triennial GRCs provide for the utility to take reasonable risks and control costs in the long and short run; (3) to prepare the company to operate effectively in the increasingly competitive energy industry; and (4) to reduce the administrative



costs of regulation. (55 CPUC2d 592, 615-616.) UCAN proposes that these base rate reform objectives be established as evaluative criteria to be incorporated into the gas procurement monitoring and evaluation program. However, we find them to be generally inappropriate as criteria for ongoing evaluation of the proposed gas procurement PBR, and we decline to adopt them for that purpose. They were established by the Commission to provide an analytical framework for determining whether the traditional GRC approach to setting SDG&E's base rates could be improved upon. They seem to have little relevance to evaluation of the new gas procurement PBR in the future.

UCAN further proposes that we adopt as evaluative criteria for the gas procurement mechanism certain of the criteria we considered (at 55 CPUC2d 616) in determining whether to adopt SDG&E's base rate PBR mechanism: whether the mechanism (1) removed, reduced, or provided compensation for greater risks to customers; (2) prevented or discouraged long-run strategies that work to consumers' disadvantage; (3) resulted in unintended consequences; and (4) included an explicit provision for monitoring and evaluation. Again, these are not necessarily relevant or appropriate as criteria for ongoing evaluation of the gas PBR.

UCAN proposes consideration of the ability of the Commission to judge the success of the mechanism as another criterion for evaluating the mechanism. We take this to mean that UCAN believes that the monitoring and evaluation program itself should be evaluated. As long as SDG&E and ORA fulfill the various reporting requirements which the settlement imposes on them, we expect that the monitoring and evaluation program will meet the objective of presenting the Commission and the parties with sufficient information and analysis during the term of the PBR mechanism. However, SDG&E and ORA should address any monitoring and evaluation deficiencies they may become

aware of in their respective annual reports. Also, we should be alerted to any unintended consequences that need to be addressed by the Commission.

Similarly, we need to be alerted to exogenous factors such as changes in state and federal regulatory policy or market developments that may affect the need for or appropriate form of the gas procurement PBR.

### **3.5.3 Other Monitoring and Evaluation Modifications**

To address other asserted deficiencies in the proposed monitoring and evaluation program, UCAN proposes that the program be modified to include formal reviews which would occur at the mid-term of the program and at the conclusion of the five-year term. These reviews would include reports by SDG&E and by an outside firm chosen by the Commission and contracted with SDG&E, and access to data would be made available to all parties who are not SDG&E competitors. The final (fifth-year) review would include a comparison of SDG&E's gas purchase and storage costs to those of other utilities and would assess whether there were any unanticipated consequences. UCAN also proposes that the Energy Division as well as ORA be charged with responsibility for conducting annual evaluations of the program. Finally, UCAN proposes that there be express recognition that the Commission will welcome a petition for modification of the benchmark if the CBI is not representative in the future.

We understand UCAN's proposals as a call for a more formal monitoring and evaluation program. UCAN has not persuaded us that such a program is necessary. We believe that annual reporting by SDG&E and ORA as proposed in the settlement agreement, along with provision for petitions for modification and the enhanced reporting requirements described below, provide adequate means of keeping the parties and the Commission informed about the status of the PBR mechanism and the need for any modifications to it. In light of

the Commission's resource constraints and the lack of a demonstrated need for analysis by an additional staff organization, we decline to impose additional reporting requirements on the Energy Division.

We acknowledge UCAN's concerns regarding the CBI and whether it will remain a representative market indicator in the future.<sup>2</sup> In reviewing these and other concerns raised by UCAN, we are persuaded that the monitoring and evaluation program would be enhanced if we provide some direction to the expected content of the annual evaluation reports by SDG&E and ORA. Accordingly, we direct SDG&E and ORA to explicitly address the following topics in their respective annual reports on the gas PBR mechanism. These requirements are intended as supplements to the reporting requirements proposed in the settlement agreement.

Has the gas procurement PBR mechanism resulted in SDG&E's providing reliable gas supply at competitive rates and with measurable ratepayer benefits?

Does the PBR benchmark, including the CBI component, remain a valid market indicator for purposes of targeting SDG&E's gas procurement performance?

How do the costs of gas procurement paid by SDG&E ratepayers compare to those paid by customers of other California gas utilities?

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<sup>2</sup> Our experience has shown that the appropriateness of a given benchmark can change over time. In D.93-06-092 we thought that Part B would increase in importance relative to, or even replace the need for, Part A's measure of in-basin gas procurement performance. We said that we might eventually modify the gas procurement experiment by eliminating the Part A benchmark and using only Part B (50 CPUC2d at 204), yet today we adopt a PBR based solely on Part A in light of ORA's determination that Part B is outdated.

Have there been unanticipated consequences of the mechanism which require Commission action to modify it?

Have there been changes in state or federal regulatory policy, market developments, or other factors which could affect the gas procurement PBR mechanism and which require Commission action to modify it?

### ***3.6 Term of the Mechanism***

The settlement agreement provides that the modified PBR mechanism will become effective upon approval by the Commission, but no sooner than August 1, 1998. As explained later, we provide that the mechanism may become effective following filing of acceptance by the settling parties of certain modifications to the settlement agreement.

Even though D.97-02-012 directed SDG&E to file an application for a permanent gas procurement mechanism, the settlement provides for a term of five years or until the Commission orders modifications. Other than a reference to this as the "initial" five-year term, the settlement does not state the settling parties' intention for the mechanism at the conclusion of the initial five-year term (and in the absence of any Commission order). However, it would seem pointless to provide a limited term unless the parties intended for the program to be discontinued in the absence of a future Commission order.

While we do not object to the proposal to place a term limit on the mechanism, we think it is important to have a more definite plan for what will occur at the end of the five-year term. We therefore direct SDG&E to file, no later than the end of the fourth year, an application to extend, modify, or discontinue the mechanism. In the event that SDG&E proposes discontinuing the PBR mechanism, it shall offer an alternative proposal for regulation of its gas procurement. We recognize that the Commission may have occasion to order

modifications to the PBR mechanism before this application is due, and that such modifications may include extending the five-year term. Thus, we will provide that this requirement may be waived by Commission order prior to the required filing date.

### **3.7 Conclusion**

The settlement is the result of extensive discussions, workshops, and negotiations held during most of 1997 and the first part of 1998. The settling parties, who represent a spectrum of utility, competitor, and ratepayer interests, assert that each party negotiated the settlement with full knowledge of the positions, strengths, and weaknesses of each other party's position and the risks of an unfavorable outcome. Each of them has been involved in SDG&E's gas procurement PBR mechanism since its inception in 1993, and therefore has a great deal of expertise in the subject matter. We find that the settlement process was fair and was conducted in accordance with our applicable procedural rules.

Rule 51.1(c) establishes criteria for review of the settlement: the Commission will not approve stipulations or settlements, whether contested or uncontested, unless the stipulation or settlement is reasonable in light of the whole record, consistent with law, and in the public interest. Rule 51.7 provides that the Commission may reject a proposed stipulation or settlement without hearing whenever it determines that the stipulation or settlement is not in the public interest.

As noted above, the whole record consists of the original application, the protests, and the settlement and related filings. Using the settling parties' comparison exhibit as a guide, we have evaluated this record and the parties' positions. We conclude that the settlement agreement provides a fair resolution of contested issues and is therefore reasonable in light of the record.

Adoption of a modified PBR mechanism governing SDG&E's gas procurement is clearly within the Commission's purview, and no party has identified any provision of the settlement which contravenes applicable law. We conclude that the settlement agreement is consistent with the law.

We further conclude that the settlement agreement is in the public interest. Procedurally, it furthers the goal of reduced litigation expenses and conserving Commission resources and it reduces parties' risk of unacceptable outcomes of litigation. Substantively, the settlement offers a PBR design consisting of a market price benchmark and revenue sharing which should provide SDG&E with an effective incentive to maintain a reliable gas supply at competitive rates with measurable benefits to customers.

### **3.8 Implementation**

The additional monitoring and evaluation reporting requirements discussed earlier are fairly straightforward and should not be burdensome to SDG&E or ORA. They represent only minor modification to the settlement agreement. Nevertheless, we acknowledge the settling parties' intent that all portions of the settlement agreement are interdependent. Technically, we are rejecting the settlement agreement by requiring additional reporting. Accordingly, and consistent with Rule 51.7, we will allow the settling parties reasonable time within which to elect to accept the additional reporting requirements or to request other relief.

The settling parties agree that if the Commission does not adopt the recommendations without change or condition, they will convene a settlement conference within 15 days after the Commission action to discuss whether to resolve by settlement the unchanged portions. We find it is reasonable to require the settling parties to file their acceptance of the enhanced reporting

requirements or alternative relief within 20 days from the date of this order. The mechanism will become effective following the filing of such acceptance.

### **Findings of Fact**

1. UCAN neither requests that hearings be held nor identifies disputed factual or legal issues.
2. The record of this proceeding provides an adequate and reasonable basis for resolving contested monitoring and evaluation issues as well as the uncontested portions of the settlement agreement.
3. The settlement provides a reasonable compromise of disputed PBR design issues, including but not limited to issues regarding SDG&E's original proposal to retain CITCS treatment in combination with a rate cap, the lack of a sharing provision in SDG&E's proposal, and other deficiencies asserted in the protests.
4. The proposal for 25% ratepayer and 75% shareholder sharing of losses above the 2% deadband should create a strong incentive for SDG&E to avoid such losses, which in turn should align shareholder and ratepayer interests.
5. The settlement agreement's proposed PBR design is uncontested.
6. Evaluation reports on SDG&E's gas procurement PBR experiment have been favorable, and there are no suggestions that we return to reasonableness review of SDG&E's gas procurement.
7. The settlement agreement's provision for advice letter filings and related procedures for the disposition of PBR rewards and penalties gives all interested parties reasonable opportunity to register their concerns about such rewards and penalties and have them resolved by the Commission.
8. Compared to the procedure adopted in D.93-06-092, the provision for advice letter filings and related procedures is a better approach for timely and

efficient disposition of PBR rewards and penalties which are pending under the current mechanism and which will accrue under the replacement mechanism.

9. ORA and SDG&E have agreed that SDG&E is entitled to rewards of \$2,062,356 and \$212,533 for Year 2 and Year 3 of the current gas procurement PBR mechanism, respectively, and no party has stated opposition to these rewards.

10. The settlement agreement's provisions for a Year 4 reward of \$7.0 million and for no adjustments for the costs paid by SDG&E ratepayers for load balancing on the SoCalGas system are reasonable compromises of the litigation positions of SDG&E and ORA.

11. Proposals for disposition of rewards and penalties pending under the current PBR mechanism are technically beyond the original scope of this proceeding, but the parties in this proceeding are essentially the same as those who addressed gas procurement PBR issues in A.92-10-017 and therefore have received notice of such proposals.

12. Annual reporting by SDG&E and ORA as proposed in the settlement agreement, along with provision for petitions for modification and the enhanced reporting requirements adopted today, should provide adequate means of keeping the parties and the Commission informed about the status of the PBR mechanism and the need for any modifications to it.

13. The proposed monitoring and evaluation program would be enhanced if SDG&E and ORA explicitly address the following topics in their respective annual reports on the gas PBR mechanism in addition to meeting the reporting requirements proposed in the settlement agreement.

Has the gas procurement PBR mechanism resulted in SDG&E's providing reliable gas supply at competitive rates and with measurable ratepayer benefits?



Does the PBR benchmark, including the CBI component, remain a valid market indicator for purposes of targeting SDG&E's gas procurement performance?

How do the costs of gas procurement paid by SDG&E ratepayers compare to those paid by customers of other California gas utilities?

Have there been unanticipated consequences of the mechanism which require Commission action to modify it?

Have there been changes in state or federal regulatory policy, market developments, or other factors which could affect the gas procurement PBR mechanism and which require Commission action to modify it?

14. To avoid regulatory uncertainty, it is important to have a definite plan for what will occur at the end of the five-year term of the PBR mechanism.

15. The settlement process was fair and was conducted in accordance with our applicable procedural rules.

16. Because the settling parties intend all portions of the settlement agreement to be interdependent, we are technically rejecting the settlement agreement by requiring additional reporting.

#### **Conclusions of Law**

1. The settlement agreement, while contested, raises policy issues for which neither hearings nor briefing is necessary

2. Pursuant to Rule 87, we should waive Rule 51.1(a) to the extent necessary for consideration of the proposals for disposition of pending rewards and penalties under the current PBR mechanism in this proceeding.

3. Whether SDG&E continues to provide its customers with a reliable gas supply at competitive rates and with measurable benefits to ratepayers should be the principal evaluation criterion.

4. No later than the end of the fourth year of the modified gas procurement PBR mechanism, SDG&E should file an application to extend, modify, or discontinue the mechanism.

5. Subject to the enhanced reporting requirements adopted today, the settlement agreement is reasonable in light of the whole record, consistent with law, and in the public interest and should therefore be adopted.

6. We should allow the settling parties reasonable time within which to elect to accept the additional reporting requirements or to request other relief.

### O R D E R

#### IT IS ORDERED that:

1. The *Joint Motion of San Diego Gas & Electric, Office of Ratepayer Advocates, and Enron Capital and Trade Resources for Order Adopting Settlement Agreement* (Joint Motion) is granted in part as provided in the following ordering paragraphs. To the extent that this partial grant of the Joint Motion represents a grant of the underlying application, said application is granted.

2. The settling parties shall file their acceptance or rejection of the enhanced reporting requirements described in the foregoing opinion, or request for other relief, within 20 days of the date of this order. If an acceptance is timely filed, San Diego Gas & Electric Company's (SDG&E) gas procurement activities and associated customer rates shall be regulated in accordance with the Gas Procurement Performance-Based Ratemaking Mechanism set forth in the Joint Motion and appendixes thereto for a term of five years, unless the mechanism is modified or discontinued by further order of the Commission.

3. SDG&E is authorized to file an advice letter which implements the Gas Procurement Performance-Based Ratemaking Mechanism set forth in the Joint Motion and appendixes thereto. The Advice Letter shall be filed on, or no later

than ten days after, the date that the settling parties file an acceptance of the enhanced reporting requirements, and shall be effective no sooner than five days thereafter.

4. The Year 4 reward for SDG&E's current gas procurement mechanism adopted by Decision 93-06-092, as modified, is \$7 million.

5. The advice letter process for resolution of Gas Procurement Performance-Based Ratemaking rewards and penalties which is described in the settlement agreement is adopted both for pending rewards and penalties under the current mechanism and for rewards and penalties which accrue under the new mechanism.

6. SDG&E and the Office of Ratepayer Advocates shall submit monitoring and evaluation reports in accordance with the terms of the settlement agreement and the foregoing discussion.

7. SDG&E shall file an application to extend the term of, modify, or discontinue the Gas Procurement Performance-Based Ratemaking Mechanism approved herein no later than the end of the fourth year of the term. This requirement may be waived by Commission order issued prior to that time.

8. In the event that the settling parties timely file an acceptance of the enhanced reporting requirements in accordance with Ordering Paragraph 2, this proceeding shall be closed.

This order is effective today.

Dated August 6, 1998, at San Francisco, California.

RICHARD A. BILAS  
President  
P. GREGORY CONLON  
JESSIE J. KNIGHT, JR.  
HENRY M. DUQUE  
JOSIAH L. NEEPER  
Commissioners

## APPENDIX C

## SDG&amp;E's New Gas PBR

Overview

The new Gas PBR measures the utility's gas purchasing performance against a monthly market price benchmark by comparing actual procurement costs for gas supplies (1) in gas production basins to the basin indices and (2) at the California border to the border index. Savings resulting from differences between the utility's actual gas costs and the market benchmark, compared at the end of each consecutive annual period, are shared equally between the utility's customers and shareholders. Actual costs which exceed the benchmark but are less than a deadband that includes an additional 2% of the basin index are paid by customers. Costs resulting from differences between the utility's actual gas costs and the new Gas PBR deadband, however, are shared 25% by customers and 75% by shareholders.

Benchmark Calculation

In order to calculate the Benchmark for each month, the Average Index and the California Border Index are first determined. The total Benchmark is then calculated using these average gas price indices and actual recorded transportation costs and volumes.

- Average Index is the average of the Basin Index price data for each of the identified sources from the San Juan and Permian basins on the El Paso and Transwestern pipeline systems. Published monthly gas price indices are taken from *Inside FERC's Gas Market Report* (bid-week), *Natural Gas Week* (average monthly data), and *Natural Gas Intelligence Weekly Gas Price Index* (bidweek).
- California Border Index is average of the Border Index price data (the "CBI") for gas delivered to the SoCalGas system. Published monthly gas price indices are taken from *BTU's Daily Natural Gas Spot Market Report* (bidweek), *Natural Gas Week* (average monthly data), and *Natural Gas Intelligence Weekly Gas Price Index* (bidweek).
- Monthly Benchmark is the sum of (1) each average basin index and associated actual transportation cost, times the actual purchased gas volume from those basins, and (2) the CBI, times the actual purchased gas volumes for all "Other Source Gas" not purchased in the identified basins.
- Annual Benchmark is the sum of the Monthly Benchmarks, in dollars.

Deadband Calculation

To calculate the Deadband at the end of the annual Gas PBR period, the monthly Gas and Transportation Cost Components need to be determined.

- Gas Cost Component is calculated in the same way as the Monthly Benchmark, except without including the actual basin transportation cost.
- Transportation Cost Component is the sum of the actual transportation cost for each identified basin, times the actual purchased gas volume from those basins.

## APPENDIX C

- Annual Deadband is the total, in dollars, of (1) the sum of the monthly Gas Cost Components, times a percentage of 102%, and (2) the sum of the monthly Transportation Cost Components.

Purchased Gas Cost

The actually incurred gas procurement costs include basin and associated transportation costs, Other Source Gas delivered costs, and Miscellaneous Costs.

- Basin Delivery Costs are the actual cost of gas purchases in the identified basins and the associated transportation cost to the California border each month, times the delivery volumes.
- Other Source Gas Costs are the actual cost of gas purchases from all sources other than the identified basin delivery points.
- Miscellaneous Costs include any additional fees, surcharges, and offsetting revenues, including expenses relating to Gas Futures transactions.
- Annual Purchased Gas Cost is the sum of these actual monthly costs, in dollars.

Shared Savings/Costs

The gas procurement results are determined at the end of each annual Gas PBR period from a comparison of the Annual Purchased Gas Cost with the Annual Benchmark and Annual Deadband. There are considered to be no Shared Savings or Shared Costs if the Purchased Gas Cost is greater than the Benchmark but less than the Deadband.

- Shared Savings are the result of calculating a positive difference after subtracting the Purchased Gas Cost from the Benchmark.
- Shared Costs are the result of calculating a negative difference after subtracting the Purchased Gas Cost from the Deadband.

Shareholder Reward/Penalty

The annual reward or penalty is determined by applying a sharing percentage to the Shared Savings/Costs in order to allocate the results between shareholders and customers.

- Reward for shareholders is calculated by multiplying the Shared Savings by 50%.
- Penalty for shareholders is calculated by multiplying the Shared Costs by 75%.

(END OF APPENDIX A)

TABLE G-1 MONTHLY GAS PROCUREMENT REPORT, SCHEDULE A (Summary)

San Diego Gas & Electric Co.  
Gas PBR Results for 1996-97

Note: Index Price Data are in \$/MMBtu

MONTH (1)	AVERAGE INDICES				CBI	Index	Gas Cost	Total Cost	Benchmark	Deadband	Shared Svgs (Costs)	Reward (Penalty)
	Permian (TW)	San Juan (TW)	Permian (El Paso)	San Juan (El Paso)								
August 1996	\$1.9833	\$1.9533	\$2.0400	\$1.9587	\$2.1100	\$2.1296	\$2.1317	\$25,200,299	\$25,175,415			
September	\$1.5633	\$1.5500	\$1.6087	\$1.5500	\$1.7233	\$1.7457	\$1.7632	\$13,113,470	\$12,983,307			
October	\$1.7233	\$1.6733	\$1.7833	\$1.6733	\$1.8900	\$1.9134	\$1.8953	\$5,193,818	\$5,098,603			
November	\$2.4887	\$2.5187	\$2.5333	\$2.5200	\$2.6500	\$2.6805	\$2.6888	\$25,936,800	\$26,944,808			
December	\$3.5733	\$3.5600	\$3.6787	\$3.5633	\$3.7287	\$3.7595	\$3.6585	\$40,248,898	\$42,522,273			
January 1997	\$3.8487	\$3.8187	\$4.0087	\$3.8187	\$4.0700	\$4.1154	\$3.9947	\$38,713,058	\$39,683,211			
February	\$2.4833	\$2.4687	\$2.4700	\$2.4687	\$2.5787	\$2.5947	\$2.6802	\$26,250,281	\$26,603,795			
March	\$1.5587	\$1.5033	\$1.5487	\$1.5033	\$1.6600	\$1.6736	\$1.4723	\$8,898,584	\$10,112,818			
April	\$1.6387	\$1.6333	\$1.6933	\$1.6333	\$1.7700	\$1.8029	\$1.1508	\$4,798,398	\$7,514,227			
May	\$1.9033	\$1.8833	\$1.9300	\$1.8833	\$2.0433	\$2.0672	\$2.0341	\$20,270,752	\$20,580,472			
June	\$2.0487	\$2.0087	\$2.0533	\$2.0087	\$2.2087	\$2.2222	\$2.2621	\$22,501,781	\$22,104,725			
July	\$2.0187	\$1.9987	\$2.0287	\$1.9987	\$2.2000	\$2.2138	\$2.2327	\$22,092,283	\$21,805,803			
Year 4 Cost Adjustment								(\$222,963)				
From August 1, 1996 Through July 31, 1997:								\$252,991,225	\$282,207,157	\$267,368,877	\$9,215,932	\$4,607,988

(1) Gas Procurement Mechanism's reporting period is on calendar month basis.

# SAN DIEGO GAS & ELECTRIC

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Table G-2. Monthly Gas Procurement Report, Schedule B.

Reporting Period: JULY 1997

SOURCE / PURCHASE TERMS (Volume in MMBtu into SoCalGas Pipeline)	SPOT PURCHASES	NON SPOT - INDEXED PRICE CONTRACTS		SPOT-INDEXED - PRICE CONTRACTS	
		Up to One Year	Longer than One Year	Up to One Year	Longer than One Year
Four Identified Basin/Receipt Points (IBP) (1)	2,257,101				
Southwest - other than 4 IBP's (2)	5,709,536			748,027	
California	90,000			8,011	
Canada	314,732				672,599
All Others	97,031				
SUB-TOTAL GAS PURCHASES	8,468,400	0	0	754,068	672,599

TOTAL GAS PURCHASES FROM ALL SOURCES:

9,895,067

MMBtu

Notes: (1) - Gas purchases for the Permian/TW IBP are from all receipt points on the Transwestern pipeline system.  
(2) - Southwest gas being delivered directly to Southern California Gas pipeline by suppliers' transportation contracts.