

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking to Address Natural)
Gas Distribution Utility Cost and Revenue Issues)
Associated with Greenhouse Gas Emissions.)

R. 14-03-003
(Filed March 13, 2014)

**PREHEARING CONFERENCE STATEMENT OF
SOUTHERN CALIFORNIA GAS COMPANY (U 904-G)
AND SAN DIEGO GAS & ELECTRIC COMPANY (U 902-E)**

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Southern California Gas Company (SoCalGas) and San Diego Gas & Electric Company (SDG&E) submit the following Prehearing Conference Statement, in accordance with Rule 7.2(a) of the Rules of Practice and Procedure of the California Public Utilities Commission (the Commission) and the Commission’s March 13, 2014 Order Instituting Rulemaking to Address Natural Gas Distribution Utility Cost and Revenue Issues Associated with Greenhouse Gas Emissions (Rulemaking or OIR).

I. INTRODUCTION AND SUMMARY

The Commission initiated this Rulemaking “to establish the policy, programs, rules and tariffs necessary for natural gas investor-owned utilities (natural gas corporations) to comply with the California Air Resources Board’s (ARB) Greenhouse Gas (GHG) Cap-and-Trade Program.”¹ As explained by the Commission, because there are “significant differences between electric and natural gas corporations, it is best to consider these issues in a separate rulemaking rather than with electric corporations in Rulemaking 11-03-012. . . .”²

¹ OIR at 1.

² *Id.*

The OIR indicates that the primary focus of the Rulemaking will be on: (1) the treatment of GHG Cap-and-Trade compliance costs that natural gas corporations may incur if they are found to have a compliance obligation under ARB's Cap-and-Trade regulation; (2) rules to govern utility procurement of Cap-and-Trade compliance instruments; (3) special considerations facing natural gas end-use customers that also have a compliance obligation under ARB's Cap-and-Trade regulation; (4) the use of revenues that natural gas corporations may receive if ARB allocates allowances to utilities for ratepayer benefit; and (5) policies concerning the treatment of emissions-intensive and trade-exposed entities that are customers of natural gas corporations. This Rulemaking will also consider natural gas corporations' forecasts of Cap-and-Trade-related costs expected to be incurred in 2015, and the potential need, scope and administrative structure of outreach and education activities targeted to natural gas customers about state efforts to mitigate climate change and Commission policy on any Cap-and-Trade-related costs and revenues.

SoCalGas and SDG&E agree with the Commission's assessment that because there are significant differences between electric and natural gas corporations, it is best to consider these issues in a separate rulemaking. Indeed, in light of those differences, it may be prudent for the Commission to adopt rules in this proceeding that differ from those adopted in Rulemaking 11-03-012. SoCalGas and SDG&E further support the Commission's preliminary description of the scope of this Rulemaking.

In order to facilitate timely participation by natural gas corporations in the Cap-and-Trade market for the benefit of their customers, in Section II below, SoCalGas and SDG&E propose a schedule for this proceeding that will enable the Commission to issue a decision resolving all outstanding issues in September 2014. If the Commission determines that it may not be feasible to resolve all outstanding issues by October 2014, SoCalGas and SDG&E request that the Commission issue an interim decision in September 2014 that: (1) adopts rules to govern the procurement of compliance

instruments by natural gas utilities; (2) sets forth a cost recovery process; and (3) authorizes the inclusion of 2015 forecasted GHG costs in rates beginning in January 2015, subject to a true-up to actual costs incurred, through a balancing account mechanism. Such an interim decision is needed to allow the natural gas utilities to participate in the ARB's November 19, 2014 auction.³ The Commission should facilitate the ability of natural gas utilities to begin procurement in the fourth quarter of 2014. Because the auction floor price will rise in 2015,⁴ compliance costs are expected to be higher in 2015, at a time when compliance requirements are also likely to increase. To implement effective procurement, management, and oversight of their large compliance obligations, the utilities may need to initiate contracts, procedures, systems and trading relationships as soon as practicable. Natural gas utilities should be provided with an opportunity to begin developing and establishing these procedures, required trading relationships and contracts immediately so that the utilities can appropriately test their systems and procedures in order to be ready to begin trading in the fourth quarter of 2014.

The resolution of other revenue return-related issues, including the policy for use and allocation of revenues from consigned allowances and the actual implementation of the 2015 revenue return, are not as time sensitive, and could be resolved at a subsequent time, if necessary.

In Section III below, SoCalGas and SDG&E elaborate on the issues that must be addressed in this Rulemaking and respond to the questions posed in the OIR. As described in those responses, SoCalGas and SDG&E seek the adoption of flexible

³ Under section 95912(f) of the ARB Cap-and-Trade Regulation “[a]n entity that intends to participate in an auction must inform the Auction Administrator at least 30 days prior to an auction of its intent to bid in an auction, otherwise the entity may not participate in that auction.”

⁴ Pursuant to section 95911(c)(3)(A) of the Cap-and-Trade Regulation, “[t]he Auction Reserve Price in U.S. dollars shall be the U.S. dollar Auction Reserve Price for the previous calendar year increased annually by 5 percent plus the rate of inflation....”

procurement rules for natural gas utilities in this proceeding to facilitate greater access to the Cap-and-Trade market and a range of procurement options in order to mitigate compliance costs for natural gas customers. SoCalGas and SDG&E further propose that the Commission authorize the implementation of two-way balancing accounts for the tracking of natural gas utilities' Cap-and-Trade-related compliance costs, adopt an advice letter process for natural gas utilities to recover Cap-and-Trade-related compliance costs already incurred, adopt an annual advice letter process for the natural gas utilities to submit public forecasts of Cap-and-Trade related costs and revenues and implement those forecasts in rates, and adopt revenue return allocation policies that will enable the natural gas utilities to return allowance auction revenues to the customers for whose benefits those allowances were allocated in as equitable a manner as possible.

II. THE COMMISSION SHOULD ISSUE A DECISION IN SEPTEMBER 2014 TO FACILITATE TIMELY PARTICIPATION IN THE CAP-AND-TRADE PROGRAM BY NATURAL GAS UTILITIES.

In order to facilitate timely participation by natural gas corporations in the Cap-and-Trade market for the benefit of their customers, SoCalGas and SDG&E propose the following schedule:

| | |
|-------------------------------|--------------|
| Prehearing Conference | April 29 |
| Gas GHG OIR Proposals | May 23 |
| Opening Comments on Proposals | June 13 |
| Reply Comments on Proposals | June 27 |
| Proposed Decision | August 11 |
| Commission Decision | September 11 |

This schedule will enable the Commission to issue a decision resolving all outstanding issues in September 2014, so that the natural gas utilities may begin procurement activity in the fourth quarter of 2014, including the opportunity to participate in ARB's November 19, 2014 auction. A delay in the Commission's decision could result in the natural gas utilities being precluded from participating in the market until 2015. The Commission should facilitate the ability of natural gas utilities to begin

procurement in the fourth quarter of 2014. Because the auction floor price will rise in 2015, compliance costs are expected to be higher in 2015, at a time when compliance requirements are also likely to increase. To implement effective procurement, management, and oversight of their large compliance obligations, the utilities may need to initiate contracts, procedures, systems and trading relationships as soon as practicable. Natural gas utilities should be provided with an opportunity to begin developing and establishing these procedures, required trading relationships and contracts immediately so that the utilities can appropriately test their systems and procedures in order to be ready to begin trading in the fourth quarter of 2014. In addition, it would be prudent for the Commission to allow natural gas utilities to diversify the purchase and sale of allowances beyond the quarterly auctions as a means to (a) reduce their exposure to bouts of adverse price volatility that may coincide with the auctions, and (b) enable them to secure favorable purchase or sale opportunities if/when they arise between auctions. Additional clarity and flexibility in the rules is needed to enable the gas utilities to participate in this manner.

Therefore, in the alternative, if the Commission determines that it may not be feasible to resolve all outstanding issues by October 2014, SoCalGas and SDG&E request that the Commission issue an interim decision in September 2014 that: (1) adopts rules to govern the procurement of compliance instruments by natural gas utilities; (2) sets forth a cost recovery process; and (3) authorizes the inclusion of 2015 forecasted GHG costs in rates, subject to a true-up to actual costs through a balancing account mechanism. The resolution of other revenue return-related issues, including the policy for use and allocation of revenues from consigned allowances and the actual implementation of the 2015 revenue return, are not as time sensitive and could be resolved at a subsequent time, if necessary.

III. RESPONSES TO ISSUES IDENTIFIED IN THE OIR

1. Cost Recovery

- a. How should the natural gas corporations track and record costs directly incurred to comply with the GHG Cap-and-Trade Program, either as a natural gas supplier or as an owner and operator of gas compression stations that may be regulated under Cap-and-Trade as Covered Entities?*

Currently, SoCalGas and SDG&E are authorized to track and recover costs incurred through 2015 to comply with the Cap-and-Trade Program as owners and operators of gas compression stations, through their respective New Environmental Regulation Balancing Accounts (NERBAs). SoCalGas and SDG&E are also authorized to record costs incurred through 2015 to comply with the Cap-and-Trade Program as gas suppliers in their respective NERBAs through 2015, and proposed to recover actual costs incurred through an advice letter process.

Prospectively, natural gas corporations should be authorized to track and record costs incurred to comply with the Cap-and-Trade Program, both as natural gas suppliers and as owners and operators of gas compressor stations, through a separate two-way Cap-and-Trade balancing account approved in this proceeding.

In the future, if the Cap-and-Trade Program is extended beyond 2020, the Commission may consider adopting an incentive mechanism for Cap-and-Trade costs similar to the Gas Cost Incentive Mechanism.

- b. How should costs related to Cap-and-Trade regulations be allocated between core and non-core gas customers?*

Costs should be allocated to all customers for whose benefit the natural gas utility incurs the Cap-and-Trade costs.

- c. What existing authority does each natural gas corporation have to track and record costs related to Cap-and-Trade regulations, and what new authority is needed?*

For Cap-and-Trade costs incurred for natural gas consumed through 2015 (both by compressor stations and by end-users), SoCalGas and SDG&E have authority to track and record these costs through their respective NERBAs. As noted above, SoCalGas and SDG&E further have authority to recover actual costs incurred as operators of compressor stations through 2015. With respect to costs incurred as gas suppliers and recorded in their respective NERBAs, SoCalGas and SDG&E propose to file an advice letter for the recovery of those actual costs.

For costs incurred for natural gas consumed in 2015 and beyond, SoCalGas and SDG&E propose to request authority to file annual GHG Cost and Revenue Forecast Advice Letters to recover Cap-and-Trade compliance costs and return revenue from consigned allowances to eligible customers. If SoCalGas and SDG&E's proposal in this OIR is adopted, Cap-and-Trade-related costs incurred for natural gas consumed in 2015 and beyond would not be recorded in the NERBAs. Instead, the costs would be tracked and recovered on a forecast basis through a separate standalone account approved through this OIR that would remain in existence throughout the life of the Cap-and-Trade Program.

2. Purchasing Rules

- a. Do natural gas corporations have appropriate existing authority to procure Cap-and-Trade compliance instruments, including allowances and offsets, as defined by ARB?*

No, more clarity is needed with regard to what procurement methods may be implemented by the natural gas utilities. As noted above, SoCalGas and SDG&E currently have authority to track and record Cap-and-Trade compliance costs in their

respective NERBAs. In the first compliance period, SoCalGas and SDG&E have compliance obligations for compressor stations and are purchasing compliance instruments to meet those obligations. Looking ahead to the second compliance period, when the obligation for small and medium-sized natural gas end-use customers begins, additional guidance regarding compliance instrument procurement rules is needed, due to the magnitude of our obligation on behalf of customers and our need to be able to access the full range of available compliance instruments in order to mitigate costs for customers.

b. What rules and limits should govern how natural gas corporations acquire Cap-and-Trade compliance instruments?

SoCalGas and SDG&E seek authorization to: (1) purchase (and sell if ARB regulations allow in the future) allowances through ARB auctions, Commission-approved exchanges, and brokers; (2) purchase offsets (including offsets where the buyer assumes the risk of invalidation) bilaterally, through brokers, and through competitive solicitation processes; (3) insure or hedge (including the use of options) the invalidation risk of offsets; (4) enter into forward contracts for delivery of future purchases up to a Commission-defined limit; and (5) sell compliance instruments under well-defined circumstances.

c. Should these rules and limits governing acquisition of compliance instruments for natural gas corporations mirror those adopted in D.12-04-046 for electric utilities?

No, the rules adopted for natural gas utilities should not mirror the current rules adopted for electric utilities. The electric utility procurement rules were adopted prior to ARB's implementation of the Cap-and-Trade Program and include restrictions adopted in an abundance of caution for the protection of electric customers facing utility participation in an unknown market. Now that the market has been successfully implemented, some of the stringent requirements, such as requiring that offsets be

acquired through an RFO process, may no longer be warranted and could be costly for utilities that do not currently have an RFO process in place to implement.

Access to the full range of available compliance instruments is important in order for utilities to better mitigate costs for customers. With respect to offsets, the assumption of buyer risk associated with invalidation may be reasonable given the current high cost of shifting that risk to the seller. The risk of offset invalidation can be managed through the use of hedging strategies and portfolio management. Some procurement restrictions currently imposed on the electric utilities are perceived as unworkable by many offset providers and, consequently, limit the available supply. Contracting with a limited pool is likely to increase costs to an extent not warranted by the benefits. As explained by ARB following its economic analysis of California's climate change scoping plan, "offsets can help contain costs within the cap-and-trade program and prevent higher energy prices for California's businesses and residents, allowing continued economic growth."⁵ SoCalGas and SDG&E would like to see rules adopted for natural gas utilities that facilitate access to ARB issued offsets created by as large a range of developers as possible. Gas utility customers may be placed at a competitive disadvantage vis a vis other participants in the Cap-and-Trade Program if gas utilities are prevented from accessing the entire Cap-and-Trade market, while unregulated compliance entities are not subject to similar market participation restrictions.

Brokers are a tool widely used within other markets by traders to improve their access to other market participants. Transacting through brokers has proven effective in natural gas procurement and would improve the access of gas utilities to other participants in the allowance and offset markets. Therefore, SoCalGas and SDG&E seek express authorization from the Commission to transact through the use of brokers.

⁵ ARB's *Updated Economic Analysis of California's Climate Change Scoping Plan* at ES-6 (March 24, 2010).

- d. Should these rules apply equally to each natural gas corporation, or should the Commission apply different rules depending on the size of the utility and whether it is an integrated electric and gas utility?*

It depends. Ideally, the Commission should adopt rules that can be applied equally to all natural gas corporations. As described above, SoCalGas and SDG&E request that the Commission adopt rules that would allow natural gas utilities to select from a variety of procurement methods to procure a variety of compliance instruments in order to facilitate greater access to the Cap-and-Trade market. If this flexible approach is approved by the Commission, there would be no need to adopt specific rules that differ according to the size of the utility or whether it is an integrated electric and gas utility.

If, on the other hand, the Commission adopts more prescriptive rules, it may be necessary to account for differences in utility size and differences between integrated and non-integrated utilities. For example, if the Commission adopted an RFO-only requirement, it may not be feasible for all utilities to comply with such a requirement without incurring an undue cost burden for their customers. As previously discussed above, because SoCalGas does not currently utilize an RFO process for natural gas procurement, it may be unduly costly to require SoCalGas customers to fund the required infrastructure to conduct an RFO to acquire offsets for only one aspect of SoCalGas' procurement process. Smaller utilities may have similar concerns.

3. Cost Forecasts and Rate Design

- a. What methodology, and what procedural mechanism, should the natural gas corporations use to forecast annual Cap-and-Trade-related costs and potential allowance revenues?*

The Commission should authorize the natural gas utilities to submit annual Cap-and-Trade-related cost and revenue forecast advice letters using publicly-available forward prices. Natural gas utilities should forecast the GHG emissions for their customers that do not participate in the Cap-and-Trade Program directly and then subtract

the number of allocated allowances forecasted to be used for direct compliance. This net remaining obligation should then be multiplied by the forward price, resulting in the forecast Cap-and-Trade direct compliance cost. The amount of revenue return to customer classes should be based on ARB regulations requiring an amount be consigned to the auction⁶ and decisions in this proceeding. Any over- or under-collections should be trued-up through the next annual advice letter submission.

i. Can the natural gas corporations rely on public, non-confidential data to report forecasts publicly without violating ARB confidentiality rules that prevent disclosure of market sensitive information?

Based on a February 19, 2014 ARB note,⁷ it appears that natural gas utilities may submit public (also referred to as “proxy”) forecasts for consideration by the Commission and interested parties without violating ARB confidentiality rules. Use of emissions based on historical emissions should similarly be public.

b. What tariff changes, if any, are necessary to include GHG costs in rates?

SoCalGas and SDG&E propose to implement a GHG Surcharge to recover the costs incurred to comply with the Cap-and-Trade Program. This will likely require SoCalGas and SDG&E to either amend an existing tariff or file a new tariff to implement the surcharge.

⁶ See Proposed Cap-and Trade Regulation § 95893 (March 21, 2014).

⁷ See March 10, 2014, Administrative Law Judge’s Ruling Supplementing the Record in A.13-08-002, et al.

- c. *Natural gas corporations may have end-use customers that are large emitters due to their on-site combustion of natural gas or other fuels and that ARB regulates as covered entities. What steps should the corporations and the Commission take to ensure that these customers are not double charged for their GHG emissions? For example, such customers would pay for emissions directly through their requirement to comply with ARB's Cap-and-Trade regulations, which cover emissions from on-site natural gas combustion, and they could also pay indirectly if their natural gas rates were to include GHG costs passed on from utilities to end-use customers.***

ARB will provide the natural gas utilities with a list of customers currently in the Cap-and-Trade Program, those who enter as a result of emissions exceeding the limit in the prior year and those opting in to the Cap-and-Trade Program, and those opting out. SoCalGas and SDG&E would only apply their proposed GHG Surcharges to the bills of customers who do not participate in the Cap-and-Trade Program directly and would not apply the surcharges to the bills of customers who participate in the Cap-and-Trade Program directly.

- d. *Should each natural gas corporation annually publish the Cap-and-Trade-related costs that may be present in natural gas rates, and can natural gas corporations publish such costs without violating ARB confidentiality rules regarding disclosure of market sensitive information?***

Yes, SoCalGas and SDG&E would publish their respective GHG Surcharge rates annually. This information can be provided to customers without violating ARB confidentiality rules because the publication of the GHG Surcharge rate will not disclose auction participation (past, present or future), auction bidding strategy, bid price, bid quantity or bid guarantee information. In addition, the forecast of GHG costs will not be based on actual compliance instruments acquired, but on customers' emissions, so the rate impact will not reveal the utility's market position.

- e. Does the Commission need to consider how to maintain competitive neutrality when deciding how natural gas utilities should address Cap-and-Trade-related costs and revenues? How can the Commission implement rules in a manner that treats Commission-regulated gas distribution utilities and non-regulated gas suppliers fairly?*

Yes, the Commission should consider the competitive neutrality implications of the regulations adopted in this Rulemaking. As discussed above, to treat unregulated and regulated suppliers fairly, the Commission should avoid imposing undue restrictions on the ability of regulated utilities to participate in the Cap-and-Trade market. As also discussed above, GHG charges and credits should be applied to the utility bills of customers who do not participate in the Cap-and-Trade Program directly and not be applied to the bills of customers who participate in the Cap-and-Trade Program directly. This is similar to how the Commission directed the utilities to recover the GHG costs for customers of non-regulated electricity suppliers.

- f. Should Cap-and-Trade-related costs be temporarily deferred from rates if the Commission has not resolved necessary cost and revenue implementation details before January 1, 2015?*

No. To avoid a potentially large under-collection that could lead to a large rate increase, the Commission should not delay the recovery of Cap-and-Trade-related costs beyond January 2015. If necessary implementation details for the return of allowance auction revenues cannot be resolved in time for a January 1, 2015 implementation date, the Commission should issue a decision by September 2014 authorizing the utilities to recover their forecasted Cap-and-Trade costs for 2015, regardless of whether all of the revenue return implementation details have been put into place. This approach will protect customers from having to pay off a potentially large accumulated backlog at the same time that they begin paying current costs, and provide a more accurate price signal.

4. Use of Revenues

- a. *If ARB adopts Cap-and-Trade regulation amendments that require natural gas corporations to consign a minimum percentage of allowances to auction, but ARB allows the Commission discretion to require higher levels of consignment, what percentage of the allowances allocated for ratepayer protection should the Commission require the natural gas corporations to consign to auction? Should the Commission endorse the ARB minimum or adopt a higher standard?*

There is no indication that ARB intended to give the Commission authority to increase the consignment percentages set forth in its regulation. The purpose of the allocation of allowances from ARB is to provide a gradual introduction to a carbon price signal for natural gas customers. Therefore, the consignment percentages in Table 9.4 of the Cap-and-Trade Regulation should be implemented as stated.

- b. *Is there reason to deviate from Commission policy established in D.12-12-033 that revenues that accrue from the auctioning of GHG allowances should be returned to customers in a manner that does not dampen the carbon price signal?*

No, as long as energy-based benchmarks are used so that customers of different sizes are treated fairly. That is, there should be a bill credit based on the share of natural gas usage for all eligible gas customer classes.

- c. *If ARB grants natural gas corporations allowances on behalf of their ratepayers, what customer classes should receive the revenues that result from the auctioning of these allowances and why? Should these revenues be distributed in a manner similar to that in D.12-12-033?*

SoCalGas and SDG&E support the return of allowance revenues in as equitable a manner as possible to all customers for whose benefit the allowance revenues were allocated. It is not yet clear whether the allowance auction revenues can be distributed in a manner that is similar to that in D.12-12-033. SoCalGas and SDG&E look forward to

working with the Commission and other interested stakeholders to develop an equitable process for the distribution of allowance revenues to natural gas utility customers.

5. Outreach and Education Activities

- a. If the Commission returns allowance revenue to natural gas end-use customers, should the Commission initiate outreach and education efforts to increase customer awareness of state efforts to address climate change and allowance revenue credits that may appear on their bills?***
 - i. If so, should such efforts leverage the same administrative structure and objectives ultimately adopted in Application (A.) 13-08-026, et al, the applications addressing GHG customer outreach activities for the electric utilities?***

The Commission has already launched a substantial outreach and education effort to increase customer awareness of state efforts to address climate change, funded through electric utility auction revenues. Rather than initiate a new, potentially costly, marketing campaign for natural gas customers, the Commission should be able to revise the existing outreach and education effort at minimal cost to include the return of revenues to natural gas customers.

6. Safety Concerns

- a. Pursuant to Public Utilities Code Section 451, we seek comment from parties and direct the respondents to specifically identify and describe safety concerns related to the issues identified in this proceeding.***

At this time, SoCalGas and SDG&E are not aware of any specific safety concerns related to the issues identified in the OIR.

IV. CONCLUSION

As discussed above, SoCalGas and SDG&E support the Commission's decision to initiate a new rulemaking to establish the policy, programs, rules and tariffs necessary for natural gas investor-owned utilities to comply with ARB's Cap-and-Trade Program

and agree with the preliminary scope of issues identified in the OIR. In order to facilitate timely participation in the Cap-and-Trade Program by natural gas utilities, SoCalGas and SDG&E request that the Commission adopt a schedule in this proceeding that will enable the Commission to issue a decision by September 2014.

Respectfully submitted,

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