PRELIMINARY STATEMENT
PART VIII
GAS COST INCENTIVE MECHANISM

A. GENERAL

The Gas Cost Incentive Mechanism (GCIM) replaces the Reasonableness Review as a means of reviewing ~~SoCalGas'~~ the Utility Gas Procurement Department's natural gas purchasing activities for retail core (core) customers. The purpose of the GCIM is to provide market-based incentives to reduce the cost of gas to core customers and to provide appropriate objective standards against which to measure the Utility Gas Procurement Department's~~SoCalGas'~~ performance in gas procurement and transportation functions on behalf of core customers.

On an annual basis, the GCIM provides the Utility Gas Procurement Department~~SoCalGas~~ with an incentive to achieve a cost of gas that is at or below the prevailing market price for gas, by establishing an annual benchmark budget. The actual gas costs incurred to meet the needs of core customers are measured against the annual benchmark budget. If the actual total gas cost is less than the annual benchmark budget, the cost savings is shared between ratepayers and shareholders based on a tiered formula with ratepayers receiving a progressively greater percentage of the GCIM gain over certain tolerances and within established sharing bands, subject to a cap on shareholders' benefit (see Section C.10~~9~~). If the actual total gas cost is greater than the annual benchmark budget plus a specified tolerance, the excess cost penalty is split equally between shareholders and ratepayers. See Section C. for the detailed methodology used to calculate these components.

~~The commodity costs under the GCIM are recorded to SoCalGas' Purchased Gas Account (PGA). The transportation reservation charges for capacity reserved for the core are recorded to the Core Fixed Cost Account (CFCA). Any additional interstate capacity acquired in excess of that reserved for the core and intended for the core use will be treated similar to other gas commodity charges and included in the PGAs.~~

B. EFFECTIVE DATES

1. A three-year experimental GCIM was approved in D.94-03-076, effective April 1, 1994. The GCIM program was modified and extended for two years by D.97-06-061, effective April 1, 1997. The GCIM program extension remained in effect through March 31, 1999.

2. Pursuant to D.98-12-057, the GCIM is extended on an annual basis for 12-month cycles, beginning in Year 6, the period April 1, 1999 through March 31, 2000, unless the mechanism is modified or discontinued by further order of the Commission.

3. D.02-06-023 approved a Settlement Agreement sponsored by the Commission's Office of Ratepayer Advocates (now Division of Ratepayer Advocates, or D~~O~~RA), The Utility Reform Network (TURN) and SoCalGas, with amendments, which further modifies the GCIM and extended it for Year 7 (April 1, 2000 through March 31, 2001) and beyond, on an annual basis until further modified or terminated upon Commission Order. N

4. ~~Pursuant to D.05-10-043, all costs and benefits associated with SoCalGas' hedging activities for the winter of 2005-2006 (November 2005 – March 2006) shall flow directly to core customers.~~ N

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GAS COST INCENTIVE MECHANISM

(Continued)

C. GAS COST INCENTIVE MECHANISM (GCIM) METHODOLOGY

1. On an annual basis, the GCIM compares the actual cost of the Utility Gas Procurement L
Department~~SoCalGas~~~~'~~'s purchases to an annual benchmark budget. The annual benchmark budget is |
the sum of twelve monthly benchmark budget amounts. |
|

2. The Monthly Benchmark Budget is the sum of monthly benchmark gas commodity costs, monthly L
benchmark commodity transportation costs, and monthly benchmark transportation reservation T,L
charges. L

3. Monthly benchmark gas commodity costs are calculated at the mainline for interstate purchases and
the border for border purchases. The Monthly Benchmark Gas Commodity Cost is the product of the T
Mainline Gas Commodity Reference Price times the volumes purchased at the mainline plus the
product of the Border Gas Commodity Reference Prices times the volumes purchased at the
respective border locations. T

   a. The Mainline Gas Commodity Reference Price consists of the weighted average of published T,D
   indices from two specified gas industry publications for the mainline trading points for each ~~of~~ N
   ~~two southwest U.S.~~ production basin~~s~~ in which the Utility Gas Procurement Department~~SoCalGas~~ |
   procures its gas supplies. It equals the product of pipeline and basin weights applied to pipeline |
   and basin specific indices reported in each of the specified publications. Each weight equals the |
   ratio of the actual gas purchased from a specific pipeline ~~[El Paso Natural Gas Company (El Paso)~~ |
   ~~or Transwestern Pipeline Company (Transwestern)]~~ and basin ~~(Permian or San Juan)~~ to the total |
   gas purchased during the month by the Utility Gas Procurement Department~~SoCalGas~~ at the |
   mainline on ~~both~~ each pipeline~~s~~. Since the Utility Gas Procurement Department~~SoCalGas~~'s |
   purchases from the Anadarko basin are minimal, these volumes are included in the Utility Gas |
   Procurement Department~~SoCalGas'~~'s Permian purchases for purposes of developing weighting |
   factors. If one publication does not report an index value for a specific basin-pipeline N
   combination for a given month, the Mainline Gas Commodity Reference Price will use the D
   corresponding index value from the other publication. T,D

   b. The Border Gas Commodity Reference Prices are based on the simple average of two published N
   indices. The Southern California Border Average indices will be used for border purchases, |
   including purchases from California and Federal Offshore production, and purchases made at the |
   California border (with the exception of volumes purchased and sold at non-SoCalGas receipt |
   points ~~on El Paso pipeline~~). |

   The Border Gas Commodity Reference Price for these Non-SoCalGas receipt points will be the |
   simple average of published indices at each of these respective receipt points. Transactions at |
   Non-SoCalGas receipt points (e.g. PG&E-Topock and Mojave-Topock) will be tracked separately N
   and the ~~value~~ cost of interstate and intrastate capacity dedicated to the core associated with
   transactions at these receipt points will flow entirely to SoCalGas' and SDG&E's core ratepayers.

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GAS COST INCENTIVE MECHANISM
(Continued)

C. GAS COST INCENTIVE MECHANISM (GCIM) METHODOLOGY (Continued)

4. The Monthly Benchmark Commodity Transportation Costs are the product of pipeline weighted commodity firm transportation rates multiplied by the total net volumes of gas actually purchased at the mainline points ~~on El Paso and Transwestern~~ (net of fuel) and transported via firm transportation agreements. ~~Additional interstate transportation costs will be flowed through as a ratepayer cost as long as total transportation does not exceed transportation necessary for retail core load.~~

5. Monthly Benchmark Transportation Reservation Charges are the pipeline transportation reservation charges for total core capacity, including credits from revenues generated through the release of core interstate pipeline capacity. ~~reserved on Transwestern and El Paso, as determined in SoCalGas' Biennial Cost Allocation Proceeding (BCAP) minus those reservation charges paid directly to interstate pipelines by core aggregators. San Juan Lateral reservation charges and all transportation reservation charges associated with additional core capacity are included as adjustments to the GCIM benchmark budget with no benefit to shareholders. Any transportation that is acquired in excess of that required for retail core load in a given month is subject to annual GCIM review~~ D

~~The Utility Gas Procurement DepartmentSoCalGas will maximize its utilization of firm interstate capacity and its purchases from the basin and mainline receipt points. Capacity utilization is deemed reasonable if the Utility Gas Procurement DepartmentSoCalGas nominates at least 95% of its unreleased capacity rights in a given month. The transportation necessary for retail core load will be determined after giving consideration to the performance of the interstate pipeline capacity, including cuts and pipeline maintenance.~~

~~All commitments for capacity will be communicated to the DORA and TURN. Commitments in excess of two years will be made with the consultation of the DORA and TURN.~~

6. The Actual Total Annual Purchased Gas Costs are the sum of the twelve monthly total actual gas commodity costs plus the sum of the twelve monthly commodity transportation costs, plus the sum of the twelve monthly transportation reservation charges (as calculated in C.5 above). The following adjustments are made to the Actual Total Annual Purchased Gas Costs:

   a. The actual cost of gas for California and Federal Offshore contracts are included in the actual purchased gas costs measured by the GCIM. The actual cost of California and Federal Offshore gas purchases are reduced by an amount equal to the Minimum Purchase Obligation (MPO) costs allocated to the noncore in rates.

   b. Any revenues generated through the release of core interstate pipeline capacity ~~on El Paso and Transwestern (including the San Juan Lateral)~~ are to be credited to the actual costs.

   c. Interstate exchange revenues are treated as credits to actual gas commodity costs.

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(Continued)

C. GAS COST INCENTIVE MECHANISM (GCIM) METHODOLOGY (Continued)

6. (continued)

d. Core gas sales will be used as a tool to reduce costs to core customers similar to other utilities and will be credited to actual gas commodity costs.

e. Imbalance charges incurred by the Utility Gas Procurement Department and net revenues that the Utility Gas Procurement Department receives for providing noncore standby and buy-back service will not be included in actual gas costs for GCIM calculations.-

f~~e~~. ~~California Energy Hub (Hub) net revenues are~~ Net revenue from secondary market transactions, such as parks and loans, is included as a credit to the GCIM actual costs. ~~On a monthly basis, the Hub net revenues are cleared from a separate Hub account and allocated to the PGA.~~

g~~f~~. Commodity cost refunds credited to the PGAs are credited to the actual cost of gas in the month during which the Utility Gas Procurement Department~~SoCalGas~~ receives the refund.

h~~g~~. Surcharge adjustments to the core cost of gas are treated as an additional cost in the month during which the Utility Gas Procurement Department~~SoCalGas~~ is billed. If the surcharge occurs due to adjustments across more than one incentive mechanism cycle, the monthly actual cost of gas will be recalculated to reflect any GCIM impacts.

i~~h~~. Any prospective refunds, surcharges, penalties, liabilities, or adjustments to purchases made during the term of the GCIM, specifically in conjunction with existing long-term contracts, shall be included as actual gas costs and are not subject to subsequent reasonableness review absent fraud or abuse.

j~~i~~. Gains and losses, including transaction costs, from all financial transactions used by the Utility Gas Procurement Department~~SoCalGas~~ to hedge natural gas prices for any portion of the November through March period (Winter Hedges) are excluded from the GCIM. The cost of Winter Hedges, and all resulting gains and losses, accrue to customers through entries to the PGA~~s~~. Gains and losses, including transaction costs, from all financial transactions other than Winter Hedges, are recorded in the PGA and included in GCIM actual commodity costs. Winter Hedges shall constitute the majority of the Utility Gas Procurement Department~~SoCalGas~~'s hedging activities. N | | N

k~~j~~. ~~Pursuant to Preliminary Statement, Part VI, Description of Regulatory Accounts - Memorandum, the Blythe Operational Flow Requirement Memorandum Account (BOFRMA) will record charges associated with SoCalGas' purchasing and delivery of gas to sustain operational flows at Blythe. GCIM actual cost will be adjusted for charges or credits to the BOFRMA.~~ L

7. The Annual Storage Inventory target on November 1 is 70.0 Bcf of the physical gas supply, with an accepted variance of +5/-5 Bcf. Minimum month-end physical storage targets for the April through October injection season will be determined based on the Utility Gas Procurement Department

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GAS COST INCENTIVE MECHANISM

(Continued)

scheduling gas into the SoCalGas system at a uniform rate from April 1 through October 31, assuming 0 Bcf in storage at March-end and filling to the minimum November 1 storage target, assuming cold year temperature demand. If the November 1 target is not attained, deliveries must be made to insure that a minimum of 60 Bcf of actual physical gas in the core's inventory is reached by December 1. The January, February and March minimum month-end targets (equivalent to peak day minimums necessary for serving the core) must be met. Any deviation from these storage targets should be explained in the Utility Gas Procurement Department~~SoCalGas~~'s annual GCIM filing.

8. No later than January 31 of each year, the Utility Gas Procurement Department will submit to the CPUC for approval via Advice Letter its annual core procurement plan ("Gas Plan"), including its winter hedging plan, which covers the upcoming 12-month GCIM period from April 1 through March 31. This Gas Plan will provide criteria and standards that the Utility Gas Procurement Department will comply with for its natural gas procurement activity for core customers.

Prior to submitting the Gas Plan to the CPUC, the Utility Gas Procurement Department will review the Gas Plan with a Procurement Review Group ("Gas PRG") which will be comprised solely by representatives of non-market participants. Members of the Gas PRG will have access to all relevant materials, including confidential data, subject to appropriate non-disclosure agreements. Market participants will only have access to redacted materials. Members of the Gas PRG, as well as any market participant or other non-market participant, will have the right to submit independent comments to the CPUC either supporting or opposing the Gas Plan, in whole or in part. -

Filed Gas Plans will become effective on April 1 for each GCIM year, subject to changes ordered by the CPUC. The Utility Gas Procurement Department will consult at least quarterly with the Gas PRG regarding the activities conducted pursuant to its current Gas Plan, as well as the development of future Gas Plans.

The CPUC's Energy Division will review the Utility Gas Procurement Department's activities for compliance with the approved Gas Plan and report its findings to the CPUC on no less than on an annual basis. Should the Energy Division find an apparent deviation from the approved Gas Plan, the Utility Gas Procurement Department will be provided an opportunity to respond and explain how its action complied with the approved Gas Plan.

Transactions by the Utility Gas Procurement Department which comply with the approved Gas Plan will be deemed reasonable per se. Any transaction which is identified as not being compliant with the approved Gas Plan will be reviewed for reasonableness using the CPUC's "reasonable manager" standard. Following the conclusion of each GCIM year, the CPUC will promptly set hearings, if necessary, and issue a decision within nine months containing its findings regarding the Utility Gas Procurement Department's compliance with the Gas Plan for the GCIM year just concluded.

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GAS COST INCENTIVE MECHANISM
(Continued)

C. GAS COST INCENTIVE MECHANISM (GCIM) METHODOLOGY (Continued)

9~~8~~. Tolerance L

To determine GCIM rewards or penalties, tolerance bands above or below the benchmark budget are used. Tolerance bands are calculated as a percentage of the monthly gas commodity portion of the benchmark budget and is added to or subtracted from the benchmark budget as "upper tolerance band" or "lower tolerance band" (sharing bands), respectively. The specific percentages are approved by the CPUC and may be redetermined in subsequent CPUC decisions (See Section 10~~9~~). L

10~~9~~. Calculation of Rewards and Penalties Under GCIM

a. On an annual basis, actual total purchased gas costs are compared to the annual benchmark budget to determine if a reward/savings or penalty applies.

b. If actual total purchased gas costs for the incentive year are less than the annual benchmark budget, the difference constitutes a savings incentive to be shared between ratepayers and shareholders as defined by the Sharing Bands as follows:

Sharing Band	Ratepayer	Shareholder
0.0% -1.00%	100%	0%
1.00% - 5.00%	75%	25%
5.00% & Above	90%	10%

The shareholder reward will be capped at 1.5% of the actual annual gas commodity costs.

c. If the actual total purchased gas costs are above the benchmark budget plus the upper tolerance band of 2%, then the difference constitutes a cost penalty, and the portion over this amount will be shared 50/50 between shareholders and ratepayers. If emergencies such as force majeure events (e.g. earthquakes and pipeline failures) cause the cost to be above benchmark, then ratepayers would absorb these incremental costs associated with that event.

D. BALANCING ACCOUNT TREATMENT OF REWARDS AND PENALTIES

Effective GCIM Year 9 (April 1, 2002 through March 31, 2003), the Utility Gas Procurement Department~~SoCalGas~~ will include the shareholder results of the GCIM from the most recent monthly report in the core monthly gas pricing advice letters submitted to the Energy Division, with copies to D~~O~~RA. SoCalGas will maintain an interest bearing balancing account associated with shareholder rewards and penalties. On June 15 of each year, the Utility Gas Procurement Department~~SoCalGas~~ will file its annual GCIM application to the Commission describing, in detail, the results of the GCIM over the past year. D~~O~~RA will conduct its annual audit and issue its monitoring and evaluation report by October 15 of each year. Any agreed upon adjustments in the shareholder incentive award or penalty for the past year will be reflected in ~~SoCalGas'~~ the next core monthly gas pricing advice letter or as mutually agreed upon by the Utility Gas Procurement Department~~SoCalGas~~ and D~~O~~RA.

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GAS COST INCENTIVE MECHANISM
(Continued)

E. REPORTING REQUIREMENTS L

1. The Utility Gas Procurement Department~~SoCalGas~~ will submit monthly reports to the Commission, providing a summary of the procurement activities under GCIM and calculations of monthly and year-to-date benchmark budget and actual purchased gas costs. These reports are due 60 days after the end of each production month.

2. Any gas sales to affiliates of SoCalGas and SDG&E will be reported, be subject to affiliate transaction rules (and any other conditions that may be ultimately adopted by the Commission), and be subject to audit by the Commission staff.

3. An annual report will be submitted to the Commission by June 15th, summarizing results of the twelve months' activities for the prior April 1 through March 31 period. This report addresses the Utility Gas Procurement Department ~~SoCalGas~~'s operations and contains a calculation of the variance between the actual gas costs and the benchmark, the cost savings, and rewards or penalties. L T,L L