Application No: ______________________
Exhibit No.: ______________________
Witness: Steven A. Watson

In the Matter of the Application of Southern California Gas Company (U 904 G), San Diego Gas & Electric Company (U 902 M) and Southern California Edison Company (U 338 E) for Approval of Changes to Natural Gas Operations and Service Offerings	)	A.06-07-___ (Filed August 28, 2006)

PREPARED DIRECT TESTIMONY

OF STEVEN A. WATSON

SAN DIEGO GAS & ELECTRIC COMPANY

AND

SOUTHERN CALIFORNIA GAS COMPANY

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA
August 28, 2006

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PREPARED DIRECT TESTIMONY OF STEVEN A. WATSON

A. QUALIFICATIONS AND PURPOSE

My name is Steve Watson. I am employed by SDG&E and SoCalGas as the Capacity Products Staff Manager. My business address is 555 West Fifth Street, Los Angeles, California, 90013-1011.

I received a Bachelor's degree from the University of California, Davis, in History and International Relations and a Master's Degree in Public Policy from the University of California, Berkeley. I have been employed by SoCalGas since 1986. I have worked in Gas Supply, Customer Services, the Strategic Planning and Transmission Capacity Planning Departments. I am currently the Capacity Products Staff Manager, responsible for staff support to the line managers in the development of new transmission services, interstate commitments, supplier interconnects, and storage services. Before joining SoCalGas I worked as a natural gas analyst at the Department of Energy.

I have previously testified before this Commission.

The purpose of this testimony is to sponsor the Continental Forge Settlement Provisions (in Sections I.A.5, I.A.7, I.A.8, and I.C of Attachment A) and Edison Settlement provisions (in Sections 5, 6, 7, 14, and 15 of Appendix B) affecting the unbundled storage program. The effect of those settlements is reflected primarily in the three attached tariffs: G-TBS, NSBA Preliminary Statement (see testimony of Reggie Austria), and the new G-SMT, as well as the closing of current existing tariff schedules G-LTS, G-AUC, and G-BSS. I will also explain how these settlements relate to and expand upon SoCalGas' previous testimony about storage infrastructure development submitted in Phase 2 of the Gas OIR (R.04-01-025).

B. SECONDARY MARKET DEVELOPMENT

The primary result of the Continental Forge Settlement with respect to unbundled storage is in Appendix A, I.5.

> *A secondary market for … storage capacity rights {will be} administered by SoCalGas. Such mechanism will enable firm rights holders to trade their … firm storage capacity rights, separately and in whole or in part, on a permanent or short-term basis.*

Consequently, SoCalGas is submitting the new G-SMT tariff, attached as Appendix X, which implements a flexible, efficient secondary market for storage.[1] SoCalGas has always been supportive of the development of such a market, as long as it is permitted the recovery of the significant costs of implementing the relevant IT systems for such a market. That recovery is provided for in Section I.8. of Attachment A in the Continental Forge Settlement.

> *SoCalGas and SDG&E will recover in customer rates all reasonable costs of establishing and maintaining … Storage rights and a secondary market for such rights.*

Secondary market trading will enhance the long-term value of storage and enhance price discovery in the market. A secondary market should also address concerns about SoCalGas being the sole provider of storage in Southern California, since any holder of storage rights will be able to trade those rights in secondary markets and, thus, compete with additional direct sales of storage by SoCalGas through the unbundled storage program. Consistent with the Edison Settlement, the attached G-SMT tariffs make clear that the Utility Gas Procurement Department (core) and core aggregators will have the same secondary market trading rights as any noncore customer.

G-SMT is very similar to the secondary market trading provisions described for firm access rights in the proposed G-RPA tariff.[2] Holders of firm storage rights will be able to sell any component of their storage package (e.g., inventory, injection, or withdrawal) for any length of time. All of the trading will be performed on an EBB that generally complies with NAESB standards.

C. NONCORE STORAGE BALANCING ACCOUNT (NSBA) SHARING

Section 5 of Appendix B to the Edison Settlement endorses the continuation of a 50/50 risk sharing regime for unbundled storage until April 2012. The Edison Settlement also specifies a

[1] Currently customers can only assign their entire storage contract for the remainder of the storage contract term. (See Special Condition 14 in the current G-TBS tariff.)

[2] A.04-12-004.

shareholder earnings cap of $20 million/year, which is about equal to the peak annual amount reported in the NSBA sharing reports for calendar year 2005.[3] SoCalGas supports these settlement provisions as providing a balanced outcome for customers and shareholders. The allocation of the costs and revenues for any unbundled storage to this 50/50 NSBA sharing account creates the symmetry that was described as necessary for unbundled storage program investments under a 50/50 environment.[4] The $20 million/year shareholder earnings cap under the 50/50 NSBA mechanism (as well as G-TBS product price caps) changes proportionally with changes in the unbundled storage revenue requirement associated with inflation, CPUC decisions (e.g., a general rate case, BCAP), and unbundled storage expansion.[5]

D. G-TBS

Section 6 of Appendix B to the Edison Settlement endorses the market-based G-TBS program (as modified by that Settlement) as the vehicle for making all unbundled storage sales. Additionally, the Edison Settlement provides for new G-TBS price caps by product that are well below the current $14.27/dth level. (See below)

	Today	Settlement
Firm Inventory	$14.27/dth	$1.63/dth
Firm Injection Capacity	None	$60/dthd
Firm Withdrawal Capacity	None	$30/dthd
Any bundled Product	$14.27/dth	Varies, but much lower for all annual deals[6]
Interruptible injection or withdrawal, per day	$14.27/dth	$2/dth

[3] Advice No. 3629, Section II B. Earnings Sharing Update, p. 3, NSBA, filed on May 1, 2006.

[4] See Section G of Watson Testimony in Phase 2 of Gas OIR (R.04-01-025).

[5] See G-TBS component price cap escalations and formulas laid out in the Preliminary Statement, Part III, Section B Revenue Requirement, #8 Noncore Storage Balancing Account (NSBA) Balance.

[6] For example, the effective cap for a package with 1 MMdth inventory, 10 Mdthd injection and 10 Mdthd withdrawal (~1.8 cycles per year) would be $2.53/dth; the effective cap for a package with 1 MMdth inventory, 20 Mdthd injection and 20 Mdthd withdrawal (~3.7 cycles per year) would be $3.43/dth, and the effective cap for a package with 1 MMdth inventory, 20 Mdthd injection and 100 Mdthd withdrawal (~6.1 cycles per year) would be $5.83/dth.

The Edison Settlement also specifies additional transparency for the G-TBS program through the posting of G-TBS contract details by the next business day, including the transaction price. The component rate caps are applicable for one-year periods, subject to specified escalation terms. Furthermore, the injection and withdrawal component caps are for capacity for any period up to one year. SoCalGas will sell capacity up to one-year increments if a customer requests an annual or multi-year term and adequate capacity is available. However, SoCalGas continues to retain the G-TBS program's flexibility to bundle its products to avoid temporal stranding. For example, SoCalGas does not have to sell inventory for one month at 1/12th of $1.63/dth at the risk of stranding inventory in the other months.

SoCalGas also retains the flexibility to bundle the products to avoid stranding any particular product. For example, SoCalGas can choose to avoid inventory-only sales, which might, under some circumstances, risk stranding injection and/or withdrawal products. In addition, SoCalGas retains the flexibility to limit sales of packages with very high levels of injection and/or withdrawal—which may have the effect of leaving it with significant inventory to sell without associated firm injection and withdrawal. (The maximum tariff price of the components within these discretionary packages, however, remained capped as per the Settlement).

In agreeing to component rate caps within its G-TBS program, SoCalGas ensured that the price caps were above its estimates of the 15-year levelized cost of expanding each product and the market prices obtained in its unusually strong 2006 Storage Open Season. This should ensure that the G-TBS program can provide the proper price signals for storage expansions and set a reasonable limit on the price for available storage capacity during periods of high demand/high market value.

	Settlement Cap	Table 12, 15-year expansion cost	2006 Open Season
Inventory	$1.63/dth	$0.60/dth	$1.35/dth
Injection Capacity	$60/dthd	$39.90/dthd	$39/dthd
Withdrawal Capacity	$30/dthd	$20/dthd	$11.60/dthd

The Edison Settlement specifies that all other storage schedules should be closed to new subscription for the five-year settlement period since the new G-TBS schedule, attached as Appendix Y, is to be the vehicle for all new unbundled storage transactions. This closure includes G-LTS, G-BSS, and G-AUC schedules (see Appendix Z). G-AUC has not been used at all, and less than 0.2 Bcf has been is sold under G-BSS. Finally, revisions to the G-TBS tariff make the G-LTS tariff unnecessary.[7]

Currently, SDG&E has a G-TBS contract for storage in the following quantities during the 2007/8 storage year: 9 MMbtus of inventory, 42 MMbtus/day of firm injection, and 297 MMBtud/day of firm withdrawal. The revenues from this contract are part of the unbundled storage program. The testimony of Mr. Goldstein describes how the SoCalGas-SDG&E G-TBS contract will be treated upon implementation of the combination of the core procurement function.[8]

E. STORAGE DEVELOPMENT PLAN

Sections 14 and 15 of Appendix B to the Edison Settlement commit SoCalGas to provide a "Storage development plan to increase storage capacity….This incremental capacity will be made available to SoCalGas customers on an open access basis."

SoCalGas believes that the Long-Term Storage Open Season described in its Phase 2 Gas Market OIR testimony is consistent with this language. SoCalGas is in the process of updating the information in that filing because the CARE Cushion 2 project used 3 of the 5 Bcf of inventory expansion at Aliso Canyon contemplated in that filing and because more accurate data on compression costs for injection are available. SoCalGas would like to hold such an Open Season by the end of 2006. Parties should recognize that short-term strength in the storage market does not guarantee that there will be sufficient interest in longer-term (term sufficient to recover the marginal cost of investment for expansion) to warrant an expansion.[9] Parties should also

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7 The new G-TBS tariff incorporates the current G-LTS requirement that storage contracts with terms of more than three years need to have CPUC approval (see Special Conditions 5 and 15 in the current G-LTS tariff).

8 As noted in Resolution G-3387, the price for the withdrawal rights is $11.60/mmbtu/day of capacity.

9 To the extent the Open Season interest can be easily accommodated with existing unsubscribed capacity, then expansion may not be warranted.

recognize that expansions will require several years (depending on the exact nature of the expansion) of lead time before they can be effectively offered to the market. If expansions do occur as a result of this Open Season, however, new development plans will be developed in anticipation of future Open Season.

This concludes my prepared testimony.