

PRELIMINARY STATEMENT
PART VIII
GAS COST INCENTIVE MECHANISM

Sheet 1

A. GENERAL

The Gas Cost Incentive Mechanism (GCIM) replaces the Reasonableness Review as a means of reviewing the Utility Gas Procurement Department's (Gas Acquisition) 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 performance in gas procurement and transportation functions on behalf of core customers.

On an annual basis, the GCIM provides the Utility Gas Procurement Department 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.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.

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 DRA), 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.

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B. EFFECTIVE DATES (Continued)

4. D.07-12-019 approved the consolidation of SoCalGas' and SDG&E's core procurement functions into one gas portfolio to be managed by SoCalGas (the Utility Gas Procurement Department) and subject to SoCalGas' GCIM.
5. Pursuant to D.10-01-023, 25% of all net gains and losses attributable to the SoCalGas/SDG&E winter hedging program shall be included within the GCIM. The remaining 75% of all net gains and losses attributable to the SoCalGas/SDG&E winter hedging program shall be directly allocated to core customers.

C. GAS COST INCENTIVE MECHANISM (GCIM) METHODOLOGY

1. On an annual basis, the GCIM compares the actual cost of the Utility Gas Procurement Department'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 benchmark commodity transportation costs, and monthly benchmark transportation reservation charges.
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 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.
 - a. The Mainline Gas Commodity Reference Price consists of the weighted average of published indices from two gas industry publications for the mainline trading points for each production basin in which the Utility Gas Procurement Department 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 publications. Each weight equals the ratio of the actual gas purchased from a specific pipeline/basin to the total gas purchased during the month by the Utility Gas Procurement Department at the mainline. Since the Utility Gas Procurement Department's purchases from the Anadarko basin are minimal, these volumes are included in the Utility Gas Procurement Department's Permian purchases for purposes of developing weighting factors. If one publication does not report an index value for a specific pipeline/basin combination for a given month, the Mainline Gas Commodity Reference Price will use the corresponding index value from the other publication.

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

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

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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, Mojave-Topock, Malin, etc.) will be tracked separately.

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4. The Monthly Benchmark Commodity Transportation Costs are the sum of commodity firm and interruptible transportation charges incurred by the Utility Gas Procurement Department for each pipeline it holds capacity on.

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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.

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

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b. Any revenues generated through the release of core interstate pipeline capacity are to be credited to the actual costs.

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

6. Actual Total Annual Purchased Gas Costs (Continued)

- c. 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.
- d. California Energy Hub (Hub) net revenues are 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. The California Energy Hub and related tariffs will no longer be utilized by the Utility Procurement Department once the California Energy Hub operations are transferred to the System Operator pursuant to D.07-12-019.
- e. Net revenues (after operating expenses) from secondary market transactions utilizing core assets, such as parks and loans, including secondary market transactions occurring prior to the transfer of the California Energy Hub operations to the System Operator, are included as a credit to the GCIM actual costs.
- f. 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. Imbalance reports will be provided to the Commission as part of the monthly and annual GCIM reports.
- g. Commodity cost refunds credited to the PGA are credited to the actual cost of gas in the month during which the Utility Gas Procurement Department receives the refund.
- h. Surcharge adjustments to the core cost of gas are treated as an additional cost in the month during which the Utility Gas Procurement Department 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. 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. Seventy-five per cent of the gains and losses, including transaction costs, from all physical and financial transactions included in the SoCalGas/SDG&E winter hedging program (Winter Hedges) are excluded from the GCIM. Seventy-five per cent of the cost of Winter Hedges, and all resulting gains and losses, accrue to customers through entries to the PGA. Twenty-five per cent of the gains and losses, including transaction costs, from Winter Hedges, and 100% of the gains and losses, including transaction costs, from all physical and 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's hedging activities.

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

- k. Pursuant to Preliminary Statement, Part VI, Description of Regulatory Accounts - Memorandum, the Blythe Operational Flow Requirement Memorandum Account (BOFRMA) will record charges associated with the Utility Gas Procurement Department's purchasing and delivery of gas to sustain operational flows at Blythe. GCIM actual cost will be adjusted for charges or credits to the BOFRMA. Entries to this account, except for interest and amortization, along with related GCIM adjustments, ceased on April 1, 2009, the date the responsibility for managing minimum flow requirements for system reliability was transferred from the Utility Gas Procurement Department to the System Operator pursuant to D.07-12-019.
7. The Annual Storage Inventory target on November 1 is 79 Bcf of the physical gas supply, with an accepted variance of +5/-2 Bcf. This target does not include any park or net loan positions. If the November 1 target is not attained, deliveries must be made to insure that a minimum of 69 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 SoCalGas' annual GCIM filing. SoCalGas has obtained agreement from DRA and TURN for a mid-season storage target of 47 Bcf as of July 31, 2011, which is a minimum storage level SoCalGas must meet unless otherwise agreed to by DRA and TURN. This target may include net loan positions.
8. Tolerance. 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 9).
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.

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

9. Calculation of Rewards and Penalties Under GCIM (Continued)

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.

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D. BALANCING ACCOUNT TREATMENT OF REWARDS AND PENALTIES

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Effective GCIM Year 9 (April 1, 2002 through March 31, 2003), 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 DRA. SoCalGas will maintain an interest bearing balancing account associated with shareholder rewards and penalties. On June 15 of each year, SoCalGas will file its annual GCIM application to the Commission describing, in detail, the results of the GCIM over the past year. DRA 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' next core monthly gas pricing advice letter or as mutually agreed upon by SoCalGas and DRA.

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E. REPORTING REQUIREMENTS

1. The Utility Gas Procurement Department 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's operations and contains a calculation of the variance between the actual gas costs and the benchmark, the cost savings, and rewards or penalties.

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