# SB 695 Compliance Report
# To California Public Utilities Commission, Energy Division

*Southern California Gas Company*

*2018*

Southern California Gas Company (SoCalGas) appreciates the opportunity, pursuant to Senate Bill (SB) 695 and Cal. Pub. Util. Code §748 (PUC Section 748), to recommend actions that can be undertaken during the succeeding 12 months to limit utility cost and rate increases, consistent with the state's energy and environmental goals, including goals for reducing emissions of greenhouse gases. Within the framework approved by the California Public Utilities Commission (CPUC or Commission) and the Legislature, SoCalGas seeks to allocate costs fairly across its customer classes. SoCalGas recognizes that allocations of certain components of gas service costs in rates are beyond its direct control. SoCalGas' objective in developing the 2018 report is to provide useful information that the CPUC may consider as it prepares its annual report for the Governor and Legislature.

This report is structured according to the Energy Division's request. Part I of this report addresses PUC Section 748 (a) and provides a description of SoCalGas' gas revenue requirements and rates as well as the outlook of anticipated rate changes from May 1, 2018 through April 30, 2019, and the amount of the change if it is known.

Part II of this report addresses PUC Section 748 (b) and provides an overview of SoCalGas' overall rate policy, an overview of management control of rate components, and a summary of policies and recommendations for limiting customer rate impacts while meeting the State's energy and environmental goals for reducing greenhouse gases.

## I. <u>Section 748 (a) Study and Report</u>

### 1. Description of Revenue Requirements

#### A. Major Categories of Gas Revenue Requirements as Commonly Monitored Within SoCalGas

Gas revenue requirements are commonly grouped into the following four major categories: Energy Costs or Weighted Average Cost of Gas (WACOG), Transportation, Gas Storage, and Public Purpose Programs.

| Major Categories of Rate Revenue | | | | |
|---|---|---|---|---|
| | 2017 | | 2018 | |
| **Revenue Component** | **Rate Revenue** $000 | **Percentage** | **Rate Revenue** $000 | **Percentage** |
| Energy | $1,115,551 1 | 28.9% | $900,258 2 | 24.2% |
| Transportation 3 | $2,396,620 | 62.2% | $2,494,629 | 67.1% |
| Storage 4 | $18,646 | 0.5% | $18,646 | 0.5% |
| Public Purpose Program | $343,321 | 8.9% | $323,409 | 8.7% |
| **Total** | $3,855,492 | 100% | $3,718,296 | 100% |

1 Actual recorded revenue.
2 Represents estimates of the residential, core C&I, and NGV energy revenue and was derived by multiplying the 2016 CGR forecast throughput projection for 2018 by the gas price forecast for 2018.
3 The transportation component includes Authorized Base Margin, amortization of regulatory accounts, other operating costs, System Integration, and Sempra-wide adjustments.
4 A subset of transportation revenue requirement; represents costs allocated to be recovered from the Unbundled Storage Program

#### B. Trends in Gas Revenue Requirement Components

The revenue requirements outlined in the previous section directly align with rate components. At the highest level, gas rates can be described as revenue requirements divided by sales forecasts, so both revenue requirement changes and demand variations impact actual rates for gas service. Increases in the forecasted revenue requirements will impose upward pressure on rates and decreases in the forecasted revenue requirements will impose downward pressure on rates. The rate pressures created by changes in the revenue requirements are modulated by differences between actual sales and the prior forecasts that were used to set rates. Adjustments in the allocation of the revenue requirements across customer classes and tiers also impact the rates experienced by individual customers.

Customer sales volatility over time also directly impacts the rates paid by gas customers. If revenues collected from customers are impacted (higher or lower) due to volatility in sales, future rates will be adjusted (decreased or increased) so that revenues collected are at authorized levels. SoCalGas reviews sales forecasts for its service territory during cost allocation proceedings, which are currently on a three-year cycle.

1) Gas energy revenue requirements are forecast to represent approximately 24.2% of the total gas revenue requirements in 2018. In 2017, gas energy revenue requirements represented about 28.9% of the total authorized gas revenue. The gas energy revenue requirements are expected to decrease from 2017 to 2018 due to lower forecasted gas prices.

2) Transportation revenue requirements are estimated to be about 67.1% of the total gas revenue requirements in 2018. For 2017, the transportation revenue requirements were about 62.2% of the total authorized gas revenue requirement. The transportation revenue requirement increase for 2018 was due primarily to an authorized increase in the amortizations of the regulatory accounts and increases in Base Margin for attrition year.

3) Costs allocated to the unbundled storage program comprised approximately 0.5% of the total gas revenue requirements in 2017, and this level is forecasted to remain unchanged in 2018.

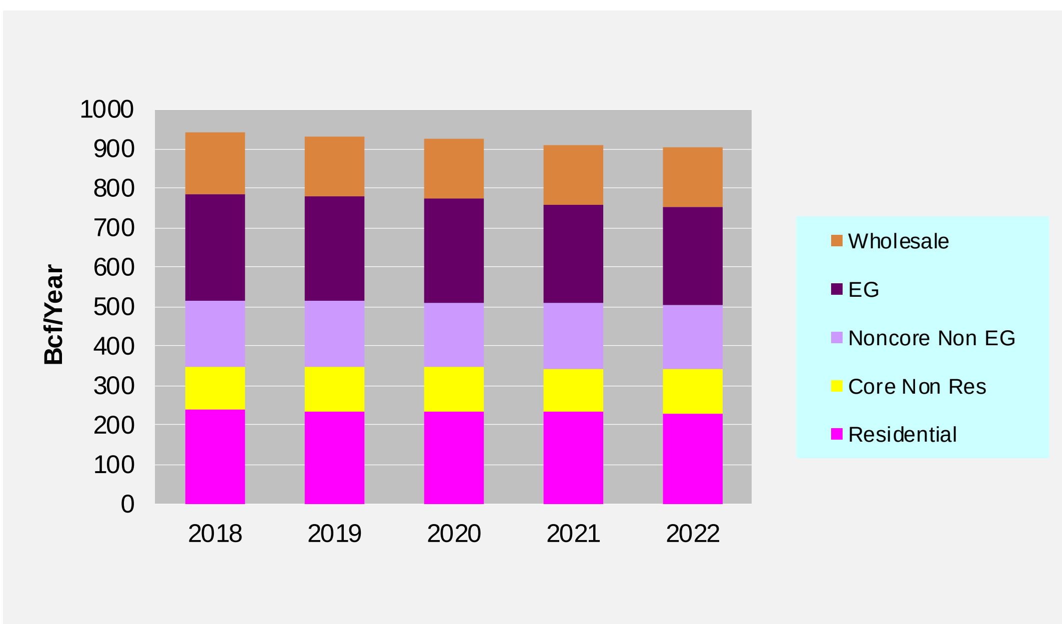
4) Public Purpose Program (PPP) revenue requirements, including California Alternate Rates for Energy (CARE) Discount and Energy Efficiency, will represent approximately 8.7% of the total gas revenue requirements for 2018.

For 2017, these programs comprised about 8.9% of the total authorized gas revenue requirements. The decrease in gross revenue requirement is occurring due to decreases in the CARE, Energy Efficiency, and amortization of regulatory accounts related to PPP.

## C. Demand Forecasts

This section outlines major categories of average year gas demand forecast through 2022.

**Composition of SoCalGas' Requirements (Bcf/Year)**
**Average Temperature and Normal Hydro Year (2018-2022)**



**SoCalGas Demand Forecasts (Bcf/Year)**
**Average Temperature and Normal Hydro Year (2018-2022)**

| Bcf | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Residential | 237 | 236 | 235 | 233 | 231 |
| Core Non Res | 113 | 113 | 112 | 111 | 109 |
| Noncore Non EG | 167 | 166 | 165 | 164 | 162 |
| EG | 269 | 264 | 261 | 253 | 250 |
| Wholesale | 153 | 152 | 152 | 151 | 151 |
| TOTAL | 940 | 931 | 925 | 911 | 903 |

The table above shows the projected average year[1] gas demand over the five-year period covering 2018 to 2022. Gas demand in 2018 is expected to total 940 Bcf. By 2022, the load is expected to have declined to 903 Bcf. Based on the 2016 *California Gas Report* (CGR), the average year load is expected to decline steadily from 2018 to 2022. The annual rate of decline from the initial year of 2018 to the year 2022 is anticipated to be -0.8%. Average year gas demand is expected to decline in the future due to the combined effects of modest economic growth, CPUC-mandated energy efficiency goals and renewable electricity goals[2], declines in commercial and industrial demand, continued increased use of non-utility pipeline systems by enhanced oil recovery customers, and savings linked to implementation of SoCalGas' Advanced Meter Program.

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[1] The demand for gas would be higher under cold weather and dry hydro conditions. As stated in the 2016 CGR, SoCalGas plans and designs its system to provide continuous service to their core customers under an extreme peak day event. The extreme peak day design criterion is defined as a 1-in-35 likelihood event for the utility's service area. This criterion correlates to a system average temperature of 40.1 degrees Fahrenheit for SoCalGas' service area.

[2] The EG gas demand forecast is surrounded by much uncertainty, given electricity demand, relatively few customers with potential large swings in usage, and sensitivity to changes in assumptions regarding new entrants. The electricity demand forecast, upon which the EG gas demand forecast is based, was agreed to by the IOU's, the CEC, and the CPUC. (Source: California Energy Commission's California Energy Demand 2016-2026, Revised/Final Forecast dated January 2016.)

## 2. Rate Outlook from May 1, 2018 to April 30, 2019

### (A) Listing of Pending Proceedings

The following table contains a listing of pending proceedings that are likely to affect rates. After the table is a short summary of each of the noted pending proceedings. Ultimately, the timing and level of impact of these pending proceedings on rates will be determined by the Commission.

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**Listing of Pending Proceedings**

| | Filing Name | Proceeding Reference (e.g. Application#) | Filing Date | Requested/Expected Implementation date | Requested Dollar Amount | | | Description | Affected Rate Components |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total Cost | 2018 RRQ | 2019 RRQ | | |
| 1 | SoCalGas 2019 General Rate Case (GRC) | A.17-10-008 | 10/6/2017, Revised 12/20/2017 | 2019 | N/A | N/A | $2.989 billion | The Application requests authority to update its Test Year 2019 (TY 2019) gas revenue requirement and base rates, effective January 1, 2019, and to implement a post-test year ratemaking mechanism that includes a return to a four-year GRC cycle. | Transportation Core increases by 15.7 cents/therm. Non-core transportation increases 0.78 cents/therm. |
| 2 | Mobile Home Park (MHP) Utility Upgrade Program | A.17-05-007 | 5/5/2017 | 2018 to 2023 | $272.8 - $309.8 million | N/A | $0.45 - $45 million/year | Application for Approval to Extend the MHP Utility Upgrade Program ("Application"). SoCalGas is requesting to recover actual costs associated with the conversion of 20% of MHP spaces to direct utility service. | Transportation Core increases by .08 to 1.18 cents/therm. Non-core transportation increases 0.003 to 0.05 cents/therm. |
| 3 | Pipeline Safety & Reliability Project | A.15-09-013 | 9/30/15 | 2020 | $633 million | N/A | N/A | Request for a Certificate of Public Convenience and Necessity (CPCN) to install a new 36-inch, 47-mile long pipeline that will transport natural gas from SDG&E's existing Rainbow metering station. | N/A |

**Listing of Pending Proceedings (cont.)**

| | Filing Name | Proceeding Reference (e.g. Application #) | Filing Date | Requested/Expected Implementation date | Requested Dollar Amount | | | Description | Affected Rate Component(s) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total Cost | 2018 RRQ | 2019 RRQ | | |
| 4 | Pipeline Safety Enhancement Plan (PSEP) 2016 Reasonableness Review | A.16-09-005 | 9/2/2016, Amended 11/20/2017 | 2018 | $163 | N/A | $67.5 million | PSEP reasonableness review requesting rate recovery for costs of certain pipeline safety projects completed by June 30, 2015 and recorded in their authorized regulatory accounts. Pursuant to D.16-08-003, SoCalGas and SDG&E have been authorized partial (50%) interim rate recovery of PSEP costs, subject to refund, and have previously incorporated costs associated with this application into rates (see Advice Letter 5017-A). | Transportation Core increases by 0.24 cents/therm. Non-core transportation increases 0.10 cents/therm. |

**Listing of Pending Proceedings (cont.)**

| | Filing Name | Proceeding Reference (e.g. Application #) | Filing Date | Requested/Expected Implementation date | Requested Dollar Amount | | | Description | Affected Rate Component(s) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total Cost | 2018 RRQ | 2019 RRQ | | |
| 5 | Gas Utility GHG OIR | R.14-03-003 | Rulemaking proceeding commenced March 2014. | 2018 | $166.1 million of 2018 compliance costs, $312.8 million of 2015-2017 revenue requirement; offset by consignment revenues of $126.4 million for 2018, $254.5 million for 2015-2017 revenues. | $166.1 million of 2018 compliance costs, $312.8 million of 2015-2017 revenue requirement; offset by consignment revenues of $126.4 million for 2018, $254.5 million for 2015-2017 revenues. | N/A | While Cap-and-Trade compliance costs would be included on a forecasted basis in the utilities' transportation rates, implementation has been delayed pending resolution of an Application for Rehearing (AFR) related to the allocation of GHG revenues. As part of the AFR, the disposition of accrued GHG costs and revenues will be also determined. | Not included, pending Decision. |

**Listing of Pending Proceedings (cont.)**

| | Filing Name | Proceeding Reference (e.g. Application #) | Filing Date | Requested/Expected Implementation date | Requested Dollar Amount | | | Description | Affected Rate Component(s) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total Cost | 2018 RRQ | 2019 RRQ | | |
| 6 | Request for Recovery of the Storage Integrity Management Program Balancing Account (SIMPBA) Balance | D. 16-06-054, Advice Letter No. 5253 | 2/8/2018 | 2019 | $15.3 million | N/A | $6.8 million | SoCalGas requests authority to recover a portion of its SIMPBA under collection balance, representing cumulative revenue requirements for reasonably incurred storage integrity management expenses in excess of the corresponding 2016-2018 General Rate Case (GRC) revenue requirements up to 35%, recorded as of December 31, 2017. | Core transportation rates will increase 0.18 cents per therm. Non-core transportation rates will increase 0.01 cents per therm. |

**Listing of Pending Proceedings (cont.)**

| | Filing Name | Proceeding Reference (e.g. Application #) | Filing Date | Requested/Expected Implementation date | Requested Dollar Amount | | | Description | Affected Rate Component(s) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total Cost | 2018 RRQ | 2019 RRQ | | |
| 7 | 2017 PSEP Forecast Application | A.17-03-021 | 3/30/2017 | 2019 | $254.5 million | N/A | $45 million | 2017 PSEP Forecast Application requesting (a) approval of the total forecasted revenue requirement and associated rate recovery for certain PSEP projects identified as part of Phases 1B and 2A; and (b) authority to (i) modify the existing Safety Enhancement Expense Balancing Accounts ("SEEBAs") and Safety Enhancement Capital Cost Balancing Accounts ("SECCBAs") to record costs discretely for Phase 1B projects, and (ii) create new balancing accounts to record costs for Phase 2 projects. | Transportation Core increases by 0.10 cents/therm. Non-core transportation increases 0.03 cents/therm. |

**Listing of Pending Proceedings (cont.)**

| | Filing Name | Proceeding Reference (e.g. Application #) | Filing Date | Requested/Expected Implementation date | Requested Dollar Amount | | | Description | Affected Rate Component(s) |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Total Cost | 2018 RRQ | 2019 RRQ | | |
| 8 | 2018 and 2019 Ratemaking Forecasts for Natural Gas Leak Abatement Program Memorandum Account (NGLAPMA), Natural Gas Leak Abatement Program Balancing Account (NGLAPBA), and Natural Gas Leak Abatement Program Subaccount (NGLAP) in the New Environmental | D. 17-06-015, Advice Letter No. 5211 | 10/31/2017 | 2018 to 2019 | \$38 - \$78 million/year | N/A | \$24 - \$49 million/year | On June 15, 2017, the Commission adopted D.17-06-015 (Decision) which, among other things, directed SoCalGas on or prior to October 31, 2017, to file a Tier 3 Advice Letter (AL) to provide the following to establish 2018 and 2019 revenue requirement forecasts and caps for the Natural Gas Leak Abatement Program, | Core transportation rates will increase 0.64 to 1.28 cents per therm. Non-core transportation rates will increase .02 to .05 cents per therm. |

### 1) General Rate Case (GRC)

On December 20, 2017, SoCalGas filed its TY 2019 GRC Revised Testimony (correcting any errors that were not feasible to incorporate into testimony at the time of October 6 Applications, A.17-10-008, and for currently known errors identified after filing) to set authorized base revenues for the four-year period 2019-2022 that will allow it to operate safely and reliably at reasonable rates over the GRC cycle. SoCalGas is requesting authorized revenues of $2.989 billion, which is a $480 million, or 19%, increase over authorized 2018 levels (at present rate, includes cost of capital true-up). SoCalGas is currently analyzing the recently enacted federal tax reform legislation. Supplemental testimony that incorporates this analysis will be served during the beginning Q2 2018. A final CPUC decision on the TY 2019 GRC is expected in the fourth quarter of 2018.

### 2) Mobilehome Park (MHP) Utility Upgrade Program

SoCalGas filed an application with the CPUC on May 5, 2017, requesting approval for continuation of its Mobile Home Park Utility Upgrade program. The proposed program is similar to the pilot program previously authorized by the CPUC in D.14-03-021, which allowed SoCalGas to convert up to 10% of mobile home park spaces to direct utility service over the three-year period of 2015-2017. In its application, SoCalGas asks that the CPUC authorize the conversion of an additional 20% of mobile home park spaces over the six-year period of 2018-2023. SoCalGas estimates the total cost of the six-year program to be $272-$309 million.

Subsequent to SoCalGas filing its application, the CPUC issued Resolution E-4878, extending SoCalGas' pilot program through December 31, 2019, and authorizing SoCalGas to convert an additional 5% of mobile home park spaces in addition to the 10% approved for the initial pilot. SoCalGas' application is still pending before the CPUC.

**3) Pipeline Safety & Reliability Project**

On September 30, 2015, SDG&E and SoCalGas (together, the Utilities) filed a joint application (A.15-09-013) with the CPUC requesting a Certificate of Public Convenience and Necessity (CPCN). The proposed project requests approval to 1) install a new 36-inch diameter, approximately 47-mile long natural gas transmission pipeline that will transport natural gas from SDG&E's existing Rainbow Metering Station, near the Riverside County line, to Marine Corps Air Station (MCAS) Miramar and 2) lower the pressure of approximately 45 miles of the existing Line 1600 for use as a distribution line, once the new line is constructed. At the direction of the CPUC, an amended application was filed on March 21, 2016. The Utilities anticipate a Phase 1 CPUC decision by Q2 2018 with Phase 2 to commence thereafter and a draft Environmental Impact Report (EIR) is expected in August 2018. The project will cost approximately $633 million and take approximately 18 months to construct after receiving necessary approvals.

**4) Pipeline Safety Enhancement Plan (PSEP) Reasonableness Review**

In September 2016, SoCalGas and SDG&E filed a joint application with the CPUC for its second PSEP reasonableness review and rate recovery of costs of certain pipeline safety projects completed by June 30, 2015 and recorded in their authorized regulatory accounts. The total costs submitted for review are $178 million ($163 million for SoCalGas and $15 million for SDG&E). SoCalGas and SDG&E expect a decision from the CPUC in 2018.

**5) Gas Green House Gas (GHG) OIR**

Beginning January 1, 2015, the Air Resources Board's (ARB) Cap-and-Trade Program expanded to include emissions from natural gas suppliers, and SoCalGas became responsible for procuring carbon allowances or offsets on behalf of its end-use customers, whom are generally those who emit less than 25,000 metric tons of $CO_2$ equivalent per year for the emissions generated from the full combustion of the natural gas SoCalGas delivers (Non-Covered Entities). Covered Entities have a direct obligation to the ARB for their own emissions; therefore, SoCalGas' obligation does not include emissions from Covered

Entities, and Covered Entities will not be responsible for compliance costs related to Non-Covered Entities incurred by SoCalGas.

In March 2014, the CPUC began a rulemaking proceeding, R.14-03-003, addressing natural gas distribution utility cost and revenue issues associated with GHG emissions and Cap-and-Trade compliance. In October 2015, the CPUC issued a decision in that rulemaking determining how the costs related to compliance with the Cap-and-Trade program would be included in utilities' rates. The decision also addressed how revenues generated from the sale of directly allocated allowances would be returned to eligible customers. Although the decision determined that all Cap-and-Trade compliance costs would be included on a forecasted basis in the utilities' transportation rates, implementation has been delayed pending resolution of an Application for Rehearing (AFR) related to the allocation of GHG revenues. As part of the AFR, the disposition of accrued GHG costs and revenues will be also determined. For 2018, SoCalGas has forecasted compliance costs to be $166.6 million and consignment revenues to be $126.4 million. Neither amount includes the unamortized balances for 2015, 2016, or 2017. A draft decision regarding the AFR is forthcoming.

**6) <u>Storage Integrity Management Program Tier 3 Advice Letter</u>**

SoCalGas filed on February 8, 2018 a Tier 3 advice letter to request authority to recover a portion of the Storage Integrity Management Program Balancing Account (SIMPBA) under-collection balance to be incorporated in SoCalGas' revenue requirement and rates.

In the SoCalGas' 2016 GRC Application, SoCalGas proposed to implement a storage integrity management program (SIMP) to identify and mitigate potential storage well safety and/or integrity issues, which was subsequently approved in Decision(D).16-06-054. Pursuant to D.16-06-054, SoCalGas established the SIMPBA, a two-way balancing account, to record and track the actual costs of implementing SoCalGas' SIMP, effective January 1, 2016. To the extent SoCalGas has exceeded the authorized revenue requirement for the three-year period, SoCalGas is authorized to seek recovery of up to 35% above the authorized revenue requirement via a Tier 3 advice letter filing. As of December 31, 2017, the revenue requirement of $34.81 million recorded to the SIMPBA has exceeded the three-year authorized revenue requirement by $15.33 million, or 78.7%. In this advice letter, SoCalGas seeks to recover 35% of $19.48 million, or $6.82 million.

The undercollection is driven by work to enhance safety and validate integrity of our Aliso Canyon, Honor Rancho, Playa del Rey, and La Goleta storage fields. The work included: (1) additional regulatory compliance activities; (2) increased program management and support efforts; and (3) accelerated and increased well inspection, workover, and mitigation activities.

**7) PSEP Forecast Application**

In March 2017, SoCalGas and SDG&E filed an application with the CPUC requesting approval of the forecasted revenue requirement necessary to recover the costs associated with twelve Phase 1B and Phase 2A pipeline safety projects. The California Utilities expect to incur total costs for the twelve projects of approximately $255 million ($198 million in capital expenditures and $57 million in O&M) to be effective in rates on January 1, 2019. SoCalGas and SDG&E expect a CPUC decision in the second half of 2018.

**8) Senate Bill (SB) 1371 Tier 3 Advice Letter**

SoCalGas and SDG&E submitted on October 31, 2017, its 2018 and 2019 Ratemaking Forecasts for the Natural Gas Leak Abatement Program Memorandum Account (NGLAPMA), Natural Gas Leak Abatement Program Balancing Account NGLAPBA), and Natural Gas Leak Abatement Program Subaccount (NGLAP) in the New Environmental Regulation Balancing Account (NERBA) pursuant to Ordering Paragraph (OP) 10 of the California Public Utilities Commission's (CPUC or Commission) Decision (D.)17-06-015. On June 15, 2017, the Commission adopted D.17-06-015 which, among other things, directed SoCalGas and SDG&E on or prior to October 31, 2017, to file a Tier 3 advice letter to provide the following to establish 2018 and 2019 revenue requirement forecasts and caps for the Natural Gas Leak Abatement Program:

a) Identify the costs for incremental costs associated with each individual Best Practice, Pilot Projects and Research & Development (R&D), broken down by type of expenditure including capital, operations and maintenance, and administrative.
b) Provide the justifications consistent with the criteria to evaluate Pilot Projects and R&D in Pub. Util. Code § 740.1.
c) The proposed allocation methodology for amortization of the account and the corresponding Commission decision authorizing the allocation methodology.

**(B) New Proceedings Likely to be Filed Between May 1, 2018 and April 30, 20198**

**Gas Cost Incentive Mechanism (GCIM) Year 24**

SoCalGas will file its GCIM Year 24 application in June 2018. SoCalGas is required to file an application and report in June of each year to address its performance under the GCIM for the previous April 1- March 31 period (GCIM Year). For reference, SoCalGas' GCIM Year 23 application recognized actual cost for all gas purchases subject to the GCIM of $1,237.8 million, while the benchmark cost was $1,210.7 million. Therefore, of the $27.1 million in savings for purchases below the benchmark, a shareholder award of $4.2 million was recognized.

**Triennial Cost Allocation Proceeding**

SoCalGas plans to file its next Triennial Cost Allocation Proceeding (TCAP) application in summer 2018 to update the allocation of its costs of providing gas service to customer classes and determine the transportation rates it charges to customers. These costs have been previously authorized by the CPUC for recovery in rates. The application will include updating the allocation of authorized costs to utility functions, as well as the demand forecasts used to set rates, for a three-year period of 2020-2022. A final CPUC decision that would impact rates would be expected in late-2019. The rate impacts of the TCAP Application are unknown at this time.

**PSEP Reasonableness Review**

SoCalGas and SDG&E anticipate filing an application in 2018 for after-the-fact reasonableness review and cost recovery of a portion of PSEP Phase 1 costs recorded in the Pipeline Safety and Reliability Memorandum Accounts (PSRMAs), Safety Enhancement Capital Cost Balancing Accounts (SECCBAs), and Safety Enhancement Expense Balancing Accounts (SEEBAs). In 2016, the CPUC issued a final decision (D.16-08-003) incorporating a forward-looking schedule to (1) file two reasonableness review applications for Phase 1 projects completed through 2017, (2) file one forecast application for Phase 2 project costs to be incurred in 2017 and 2018, and (3) include all other PSEP costs in future GRCs.

**Cost of Capital**

The utilities' cost of capital proceeding with the CPUC determines a utility's authorized capital structure and authorized rate of return on rate base (ROR), which is a weighted average of the authorized returns on debt, preferred stock, and common equity (return on equity or ROE), weighted on a basis consistent with the authorized capital structure. The authorized ROR is the rate that the California Utilities are authorized to use in establishing rates to recover the cost of debt and equity used to finance their investment in CPUC-regulated electric distribution and generation as well as natural gas distribution, transmission and storage assets. The cost of capital proceeding also addresses the automatic cost of capital adjustment mechanism (CCM), which applies market-based benchmarks to determine whether an adjustment to the authorized ROR is required during the interim years between cost of capital proceedings. The current authorized rate of return on rate base for SDG&E and SoCalGas is 7.55% and 7.34%, respectively. The utilities' next cost of capital application will be filed in April 2019 for a 2020 test year.

### (C) Anticipated Rate Changes During May 1, 2018 and April 30, 2019

In addition to potential rate changes due to pending decisions or resolutions as described above, rates are updated each year through the recurring advice letters listed in table below.

**Southern California Gas Company**
**Anticipated Rate Changes During 2018**

| Description | To Be Filed | Expected Implementation | Impacted Rate | Directional Impact | Revenue Requirement Impact ($000) | Reason for Revenue Requirement Request |
|---|---|---|---|---|---|---|
| Gas Regulatory Account Update AL | October 2018 | January 2019 | Gas Transportation | Increase | $56,732 | (1) |
| Gas Consolidated AL | December 2018 | January 2019 | Gas Transportation | Decrease | $81,920 | (1) (2) |
| Gas Public Purpose Program Update AL | October 2018 | January 2019 | PPP Surcharge | Increase | ($19,912) | (1) |

(1) Shows change from 2017 to 2018. This is an annual routine filing in which the specific financial impact for 01/2019 has not been determined.
(2) Gas Consolidated AL 5238 shows change from 2017 to 2018.

**Gas Regulatory Account Update AL** - This advice letter serves to update the amounts in the regulatory accounts to be amortized in rates over the next year.

**Gas Consolidated AL** - This advice letter consolidates advice letters that are routinely filed each year to be placed in rates the next year. This includes items such as the regulatory Account Update, authorized cost changes for the Advanced Meter Infrastructure. any attrition index authorized in the General Rate Case to be applied to the revenue requirement, Cost of Capital adjustments, and Energy Efficiency Awards.

**Gas Public Purpose Program Update AL** - The state's natural gas and electric utilities collect funds from core and non-EG noncore customers for gas related energy efficiency programs, low-income programs including the California Alternative Rates for Energy (CARE) subsidy, and for the California Energy Commission's natural gas research and development program. The annual budget for these public purpose programs is set in various recurring program-related Commission proceedings. The CARE program revenue requirement for SoCalGas' customers in 2017 was $112 million and is $106 million in 2018.

## II Section 748 (b) Study and Report

### 1. Opening comments

In this part, SoCalGas addresses PUC Section 748 (b) and provides an overview of SoCalGas' overall rate policy, an overview of management control of rate components, and a summary of policies and recommendations for limiting customer rate impacts while meeting the State's energy and environmental goals for reducing greenhouse gases. SoCalGas hopes that the CPUC will consider the recommendations set forth in this report, which SoCalGas believes can have a measurable near-term impact on its total cost of delivering safe, reliable, and cost-effective gas services to its customers in California.

### 2. Overall Rate Policy

Absent market-based prices for natural gas transportation service, SoCalGas' overall rate policy is to follow the cost causation principle whereby rates are based on the costs incurred to provide its customers with safe and reliable gas service. SoCalGas understands that its customers value safety, low rates, transparency and stability. Therefore, SoCalGas also seeks to minimize the impact of rate adjustments when they are made by phasing in impacts to avoid rate shock whenever possible. SoCalGas, like the other gas utilities in California, makes monthly advice letter filings that are publicly available to change the gas commodity rate which is based on the monthly cost of gas. SoCalGas also files for an annual gas transportation and Public Purpose Program surcharge rate change in January of each year. In addition, SoCalGas submits any required rate update filings within the year in response to specific Commission decisions that affect SoCalGas' revenue requirement.

The cost causation principle discussed above drives SoCalGas rate policy for both the allocation of costs between customer classes as well as within customer classes. When examining intra-class rate structures, costs should be recovered in rates that reflect how those costs are incurred, and SoCalGas tend to propose changes when it appears that an intra-class subsidy may be occurring.

In the TCAP Phase 2 application, filed on July 7, 2015 (A.15-07-014), SoCalGas had proposed changes to align residential rates more closely with the underlying costs of serving residential customers. Residential rates have a customer charge, and a two-tiered volumetric charge with a higher second tier rate. The customer charge (the charge a customer incurs at zero level of gas consumption) is to recover the fixed cost of hooking up a customer to SoCalGas' delivery system. These fixed costs include installation and maintenance of the gas service lines, meters, regulators, meter reading, customer billing, maintenance of facilities, and vehicles and equipment. The portion of fixed customer costs that are not recovered in the customer charge are recovered in the volumetric rates, causing volumetric rates to be higher than the underlying variable costs. Therefore, in the TCAP Phase 2 application, SoCalGas had proposed to increase the residential customer charge to approximately $10/month while at the same time reducing volumetric rates. However, the TCAP decision rejected SoCalGas' proposed $10/month customer charge and retained the existing $5/month customer charge. The current monthly customer charge of approximately $5 per month was set by the Commission in December 1994 (D.94-12-052) and has not changed since then, while the fixed costs of customer hookup have since gone up. SoCalGas believes that the Commission missed an opportunity to align rate design with cost causation and reduce intra-class subsidies. Having a cost-based higher customer charge and lower volumetric rates are likely to lower volatility in month-to-month customer bills caused by volatility in weather conditions in winter months.

### 3. Management Control of Rate Components

In order to keep rates reasonable, SoCalGas works proactively to lower gas costs and participates actively in interstate pipeline rate cases to make sure that transportation costs are just and reasonable. Also, in addition to safety and reliability, SoCalGas prioritizes operational efficiency and cost containment. In light of these priorities, SoCalGas performs continuous reviews of its systems and operations to identify areas for improved performance. Performance based incentive mechanisms, such as the Gas Cost Incentive Mechanism, align shareholder and customer interests and result in operational efficiencies and lower rates. However, there are some key drivers that affect customers' rates that fall outside of

SoCalGas' control. These include: gas commodity prices, actual sales volumes, weather, natural disasters, interest rates, economic and demographic growth, permitting process delays, and compliance with new environmental regulations and CPUC requirements. Despite these factors, SoCalGas works hard to manage its costs across all categories to make efficient and effective use of revenues collected from customers.

### 4. Utility Policies and Recommendations for Limiting Costs and Rate Increases While Meeting State's Energy and Environmental Goals for Reducing Greenhouse Gases

In this section, SoCalGas offers a set of recommendations for actions that the Commission may consider as it prepares its own annual report to the Legislature and Governor on measures that can be undertaken in the coming year to limit utility costs and rate increases. These recommendations center on factors largely out of the scope of the utilities' control, and are expected to have a significant impact on utility costs and resultant customer rates in the near- to medium-term.

SoCalGas continues to use best operating and infrastructure investment practices to limit rate increases while still meeting California's energy efficiency and greenhouse gas reduction goals. SoCalGas supports the State's Energy Action Plan by promoting all mandated energy efficiency programs. SoCalGas is working with regulators and other stakeholders on the regulation being developed by the California Air Resources Board to implement the AB 32 Cap and Trade program, such that it is fair and as cost-effective as possible. SoCalGas has also received regulatory approval to participate in the development of renewable energy sources, such as biogas and distributed energy, which will reduce GHG emissions in California. Biogas and renewable energy resources provide environmental benefits and could be useful alternatives to contracting for capacity on interstate pipelines.

The impact to SoCalGas' customers from energy efficiency, low income energy efficiency, CARE, technology research, development, and demonstration (RD&D) is shown below.

| REVENUE REQUIREMENT AS OF 1/1/18 $ millions | | | |
|---|---|---|---|
| | **Core** | **Non-Core** | **Total** |
| Energy Efficiency | $69 | $6 | $75 |
| Low Income Energy Efficiency | $129 | $0 | $129 |
| CARE | $70 | $36 | $106 |
| RD&D | $13 | $0 | $13 |

Natural gas is a clean, abundant and affordable energy source that can help California address climate change, and reduce smog while supporting a strong economy; and policy that delivers choice to our customers at reasonable rates puts our state in the best positon to successfully achieve its goals. In the coming year, SoCalGas recommends that several key State policies and procedures should be shaped to support more effective, efficient and beneficial use of revenues collected from SoCalGas' customers. SoCalGas believes that the State will have to weigh its environmental goals that cause significant upward cost pressures against its desire to moderate impacts on customers' rates for gas service. Here is a list of items in which policy decisions could drive customer rate impacts.

1. In the Gas GHG Rulemaking, R.14-03-003, several parties discussed options for addressing unamortized balances in the GHG balancing accounts. For reasons outside the control of natural gas ratepayers, the balancing accounts at the various utilities have accrued for three plus years without any of those costs being recovered in rates, and catching up on those costs would lead to a substantial rate increase for many customers while distorting the carbon price signal. Parties noted that on option for the Commission to consider is to direct the utilities to net out GHG costs for 2015 through

2017 against the available GHG proceeds from the consignment sale of directly allocated allowances for 2015 through 2017, and carry forward only the net balance. This option would serve two purposes: (1) it would limit rate impacts to customers; and (2) it would provide a more accurate carbon price signal by not amortizing significant undercollections from prior years at the same time as amortizing revenue requirements for the current year. If this option were considered, it would be a one-time event to address the backlog that resulted from the delay of this regulatory proceeding and to allow all the parties to "catch-up" on amortizing the 2015 through 2017 GHG costs and proceeds. This option would allow for a clean start to the California Cap-and-Trade program for natural gas customers and will provide a more accurate price signal going forward.

2. SoCalGas has proposed a cost-effectiveness framework in the Natural Gas Leak Abatement Rulemaking, R.15-01-008, to align with the intent of Senate Bill (SB) 1371 to achieve the maximum technologically feasible and cost-effective greenhouse gas emission reductions across operational areas such as transmission, storage, and distribution.[3] SoCalGas has received authorization for the use of SoCalGas' existing New Environmental Regulatory Balancing Account (NERBA) to track and record any incremental costs not already authorized. SoCalGas has encouraged the adoption of objective criteria that will be used to develop a list of cost-effective, technologically feasible mitigation activities and technologies that help achieve methane emission reductions in top emissions source categories. This proceeding is ongoing and a Ruling and Amended Scoping Memo was issued in Q4 of 2017 which sets forth the scope and procedural schedule for the second phase of this proceeding. The scope for Phase II consists of considering a cost-effectiveness framework; how the Commission's Annual Report Requirements and 26 Best Practices should be harmonized with information or action required by other entities; whether this proceeding should be incorporated into the applicable general orders; and how ratemaking treatment for LUAF should be structured and evaluated.

[3] *See* SB 1371 (Statutes 2014, Chapter 525), codified in CAL. PUB. UTIL. CODE § 975 (h)(1).

3. Combined Heat and Power (CHP): CHP reduces overall energy use by using waste heat to generate power. Efficient CHP entails low carbon generation and its widespread use will have greenhouse gas reducing benefits. Both the CPUC and the California Energy Commission have supported the development of CHP to meet California's energy needs because this source has the potential to contribute substantially to reducing California's Greenhouse Gas Emissions.[4] SoCalGas supports policies and programs that encourage the installation of CHP.
4. Recommend that State policy regarding the promotion of renewable energy to generate electricity does not overlook the benefits of fuel cell technology. Fuel cell technology allows for more reliable generation of electricity. A State policy promoting this use at the residential level for the generation and water heating has the potential for significant emission reductions.
5. SoCalGas recommends that flexibility be given to utilities in their energy efficiency and greenhouse gas programs in order to allow utilities to respond quickly to customer and market demands. The regulatory application process could expedite the launch of new products and services. By authorizing more limited market or technology applications and pilot programs an expedited decision process may be achieved.
6. Performance-Based Incentives Mechanisms: Continue to support the utilization of performance-based mechanisms to motivate utilities to implement programs that will lead to an overall reduction in costs and improve the efficiency of utility operations. These mechanisms work because (1) they align customers' and shareholder interests; (2) they measure a utility's performance relative to a market-based benchmark; and (3) they reduce the regulatory burden.
7. California Alternative Rates for Energy (CARE): CARE customers comprise one quarter of SoCalGas' residential volume. Non-CARE customers must cover the CARE shortfall, which is 4% of transportation costs. Safeguards should be taken so that only qualified customers are participating in the CARE program.

[4] Order Instituting Rulemaking to Implement the Commission's Procurement Incentive Framework and to examine the Integration of GHG Standards in its Procurement Policies, pp. 221, R.06-04-009.

In summary, California leads the nation in promoting the reduction of GHG emissions, adoption of advanced technologies, and expenditures on public purpose programs mandated by law. The costs associated with implementing these policies place upward pressure on utilities' rates. In addition, due to the mild weather and implementation of energy efficiency measures, the gas usage per customer in California is far below the national average. These factors lead to higher rates overall but also lower customers' bills. SoCalGas supports the above-referenced policies. To promote achievement of these important statewide goals, utilities should be provided more flexibility in implementing mandates and requirements in order to achieve lower costs for all customers.