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November 20, 2002

Advice No. 3199-A
(U 904 G)

Public Utilities Commission of the State of California

Subject: Supplemental PBR MICAM Adjustment

Southern California Gas Company (SoCalGas) hereby submits for filing and approval by the California Public Utilities Commission (Commission) revisions to its revenue requirement and rates effective January 1, 2003. This supplemental filing is made in compliance with Decision No. (D.) 97-07-054, dated July 16, 1997, in SoCalGas' Performance Based Regulation (PBR) Application No. (A.) 95-06-002.

Information

This Supplemental Advice Letter replaces in its entirety Advice No. 3199, filed October 29, 2002, in order to properly account for a gain on an interest rate swap realized in October 2002. Other than accounting for the gain on the swap in cost of debt calculations, this Supplemental Advice Letter does not differ substantially from the original Advice No. 3199.

SoCalGas has also filed on October 29, 2002 a Petition for Modification to suspend the requirement that it make this Advice Letter filing and associated revenue revisions. The Petition for Modification requests suspension of the Market Indexed Capital Adjustment Mechanism (MICAM) because yields on 30-year Treasury bonds no longer track yields on utility bonds, so 30-year Treasury bonds are no longer a good indicator for utility costs of capital. Approval of the Petition for Modification would mean that the Commission would not implement this Advice Letter.

D.97-05-054, at mimeo 48 and 49, requires that the Utility's cost of capital will be adjusted according to the MICAM formula in the event that (1) the 12-month trailing average yield of 30-year Treasury Bonds change by 150 basis points or more and (2) that the DRI 12-month ahead forecast of that yield also be below the benchmark. (Mimeo at 48). The benchmark yield is 6.95 %, making the trigger 5.45%. In October 2002, that trigger point was reached for both the trailing-average rate and for the forecast. Accordingly, this Advice Letter proposes a base margin reduction of \$10.514 million relative to the October 1, 2002 base margin update filing, Advice No. (AL) 3193.

The revised rates resulting from this decrease in SoCalGas' base margin are shown in Attachment F.

Trigger Requirements

Twelve-month Trailing Average

On October 31, 2001, the Secretary of Treasury announced that the federal government would discontinue issuance of 30-year Treasury bonds. While there is still an active market in long-term Treasury bonds, the longest-term Treasury bond matures in February, 2031—about 28 and one-half years from now. This is reflected in Federal Reserve System statistical releases, which now reference "Treasury long-term average (25 years and above)." SoCalGas' Petition for Modification provides the justification for suspension of its trigger mechanism. However, if the Commission disagrees, it should base the trigger calculation on the longest maturity available.

From October 2001 through September 2002, the average yield of the longest-term Treasury Bond is 5.38% as shown in Attachment B. The average yield is below the benchmark 5.45%, representing the 6-month average rate from April 1996 to September 1996 less the specified 150 basis points (1.50%)

DRI Forecasted Rate

A second condition for the MICAM adjustment to trigger is that the DRI 12-month ahead forecast be below the 5.45% benchmark. This condition was also satisfied when this month DRI released its October forecast of 5.31% for the 4th quarter of 2003, as shown in Attachment B.

Rate of Return and Revenue Adjustment

There are three elements defined in the MICAM rate of return adjustment. First, the cost of long-term debt is set equal to the current embedded average interest rate on outstanding long-term debt. Attachment C(1) shows the current long-term rate to be 6.96%, a reduction from the previously authorized rate of 7.71%. (See D.96-11-060.)

The second element is the current cost of preferred stock. This rate is now 4.83%, below the 6.35% previously authorized.

Finally, the previously authorized rate of return on equity was 11.60%. The reduction in the 12-month average of 30-year Treasury bonds (the trigger measure) was from 6.95% to 5.38%, or 157 basis points. Under the MICAM formula, ROE is reduced by half, or 78 basis points, to a new level of 10.82 %.

As shown further in Attachment C(1), these data, applied to the fixed structural weights (long-term debt, preferred stock, and common equity) yields an new ROR of 8.68%.

This MICAM-adjusted rate of return is multiplied by the 2002 (estimated) average ratebase of \$2,236 million to obtain a new authorized return of \$194.011 million, compared to a return of \$212.203 million based on the previously adopted ROR, a reduction of \$ 18.192 million. This reduction must be grossed up for taxes, franchise fees

and uncollectibles based on the factors shown in Attachment C(2). Thus, the MICAM procedure yields a 2003 proposed revenue reduction of \$25.947 million.

Offset Calculation

Annual “inflation less productivity” rate index adjustments under SoCalGas’ PBR adopted by the Commission in 1997 include revenue changes reflecting the estimated rental cost of capital. In particular, the capital-related component of the Gas Utility Price Index already captures, at least in part, margin adjustments due to changes in the competitive cost of funds. As a proxy for the cost of equity, the formula uses the S&P 500 dividend yield. The formula’s proxy for the cost of debt is the yield on AA utility bonds.

The 1997 PBR Decision (D.97-07-054) provides that SoCalGas shall apply the SDG&E MICAM rate adjustment mechanism from D.96-06-055 if SoCalGas’ mechanism is triggered. In a subsequent SDG&E decision, D. 99-05-030, the Commission recognized that the MICAM adjustment should consider the interaction with the existing PBR cost escalator:

In years when a MICAM adjustment is triggered, the annual cost of capital adjustments embedded in the PBR cost escalation proposal would be trued up to the MICAM adjustment cost of capital. (Mimeo at 26).

In the case of SoCalGas, its October 1, 2002 PBR update filing (AL 3193) incorporates a cumulative adjustment for the cost of capital costs within the Gas Utility Price Index (GUPI). To avoid double counting of adjustments already reflected through the GUPI escalation, it is necessary to assess the difference between margin indexed under GUPI and what margin would have been had the cost of capital been held constant at its prevailing 1997 level when PBR began.

To assess the extent to which GUPI already reflects the impact of changes in the cost of capital, SoCalGas has recalculated GUPI holding constant at average 1997 levels (1) the dividend yield for the S&P 500 and (2) the yield on AA utility bonds. Attachment D documents the DRI formulas for the utility cost of capital, rental price of capital and the adjustments applied here.

As shown in Attachment E, the effect of this adjustment is to raise GUPI by 1.03 percent for 2003. When applied to the otherwise applicable margin of \$1,501 million, holding capital-costs constant would have resulted in a margin that was \$15.433 million higher. Put differently, the proposed margin for 2003 already includes a \$15.433 million reduction due to the lower cost of capital compared to 1997.

Therefore, the net adjustment to 2003 base margin is shown below:

	Margin (millions)
MICAM	(\$25.947)
GUPI Offset	\$15.433
Net Adjustment	(\$10.514)

Protests

Anyone may protest this advice letter to the Commission. The protest must state the grounds upon which it is based, including such items as financial and service impact, and should be submitted expeditiously. The protest must be made in writing and received within 20 days of the date this advice letter was filed with the Commission. There is no restriction on who may file a protest. The address for mailing or delivering a protest to the Commission is:

Energy Division - IMC Branch
California Public Utilities Commission
505 Van Ness Avenue, 4th Floor
San Francisco, CA 94102

Copies of the protest should also be sent via e-mail to the attention of both Jerry Royer (jjr@cpuc.ca.gov) and Honesto Gatchalian (inj@cpuc.ca.gov) of the Energy Division. A copy of the protest shall also be sent via both e-mail and facsimile to the address shown below on the same date it is mailed or delivered to the Commission.

Attn: Sid Newsom
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555 West Fifth Street
Los Angeles, CA 90013-1011
Facsimile No. (213) 244-4957
E-Mail: snewsom@semprautilities.com

Effective Date

SoCalGas respectfully requests that this Supplemental Advice Letter be approved on January 1, 2003, which is more than forty (40) days regular statutory notice.

Notice

In accordance with Section III.G of General Order No. 96-A, a copy of this Supplemental Advice Letter is being sent to the parties listed on Attachment A to this advice letter, which includes the parties on the service list in A.95-06-002.

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Attachments

ATTACHMENT A
Advice No. 3199-A

(See Attached Service Lists)

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ATTACHMENT B

Advice No 3199-A

US 30-Year Treasury Bond Rates (% yield)

	Trailing 12-Month <u>Average*</u>	DRI forecast for <u>for 12 months ahead**</u>
January-00	5.87	6.40
February-00	5.99	6.22
March-00	6.06	6.17
April-00	6.10	5.97
May-00	6.12	6.00
June-00	6.15	6.34
July-00	6.14	5.82
August-00	6.13	5.55
September-00	6.10	5.77
October-00	6.08	5.66
November-00	6.05	5.60
December-00	6.01	5.70
January-01	5.94	5.14
February-01	5.85	5.53
March-01	5.79	5.55
April-01	5.73	5.66
May-01	5.71	5.63
June-01	5.68	6.03
July-01	5.66	5.91
August-01	5.64	5.97
September-01	5.62	5.65
October-01	5.59	6.00
November-01	5.55	5.39
December-01	5.49	5.69
January-02	5.49	5.88
February-02	5.49	5.46
March-02	5.48	5.95
April-02	5.51	6.14
May-02	5.51	6.16
June-02	5.50	6.42
July-02	5.49	6.53
August-02	5.47	6.17
September-02	5.44	5.53
October-02	5.38	5.31

Trigger occurs (both below 5.45%)

* The 12-month average ends with the month prior to the month indicated (i.e. for October 2002, the average is the 12-month average of October 2001 through September 2002).

** Since DRI, forecasts by quarter (not by month), the forecast is for four quarters ahead (i.e., the figure shown for October 2002 is DRI's forecast for the fourth quarter of 2003).

Recorded data source through January 2002: US Federal Reserve Board of Governors, H-15 Report.

Recorded data source beginning in Feb. 2002: monthly averages of daily close quotes for symbol ^TYX, existing 30-Year Treasury Bonds traded on Chicago Board Options Exchange.)

(The US Government stopped reporting 30-year Treasury rates as of Feb. 15, 2002.)

Attachment C(1)

Advice No 3199-A

Cost of Capital Factors and Return Revenue Requirement

	Weights	Cost of Capital		Previous		Adjusted		Return Difference	PBR ¹ Multiplier	Revenue Difference
		Previously Authorized	MICAM- Ratebase (mil.)	Wtd. Cost	Return (mil.)	Wtd. Cost	Return (mil.)			
Long-term Debt	45.61%	7.71%	\$2,236	3.52%	\$ 78,630	3.17%	\$ 70,981	(\$7,649)	1.01964	(\$7,799)
Preferred Stock	6.39%	6.35%	\$2,236	0.41%	\$ 9,073	0.31%	\$ 6,901	(\$2,172)	1.72127	(\$3,738)
Common Equity	48.00%	11.60%	\$2,236	5.57%	\$124,500	5.19%	\$116,129	(\$8,372)	1.72127	(\$14,410)
Total	100.00%			9.49%	\$212,203	8.68%	\$194,011	(\$18,192)	1.42627	(\$25,947)

¹ See Attachment C(2)

Attachment C(2)

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Net-to-Gross Multiplier

	a	b	c
	Rate	Base	Rate*Base
Gross operating Revenues			1.000000
Less: Uncollectibles	0.00478	1	0.004776 <i>0.995224</i>
Less: Franchise reqts.	0.01483	0.995224	0.014757 <i>0.980467</i>
Less State Income Tax	0.0884	0.980467	0.086673 <i>0.893794</i>
Less Federal Income Tax	0.35	<input type="text" value="0.893794"/>	0.312828
Net Operating Revenues			<i>0.580966</i>
Net to Gross Multiplier	1	0.580966	<input type="text" value="1.721272"/>

**Attachment D
Advice No 3199-A**

DRI Cost of Capital Equations (Model US_2001A, September 2002)

$$ICNRCOSTPU = PCWICNRPU / (1 + (1 - 0.6 * 0) * 0) * (2.45 / 100 + LN(1 + \underline{COSTFUNDSPU} / 100) - LN(1 + PCWGDPEXP79 / 100)) * (1 - (RTCGFS + RTCGSL * (1 - RTCGFS))) * \underline{PVDPNPU} - 0 + 0 * (RTCGFS + RTCGSL * (1 - RTCGFS)) * PVDPNPU * 0) / (1 - (RTCGFS + RTCGSL * (1 - RTCGFS)))$$

- COSTEQUITY: After-tax cost of equity
 COSTFUNDSPU: After-tax cost of financial capital to public utilities
 DBICNRPU: Multiple of straight-line depreciation rate--public utilities
 ICNRCOSTPU: Rental cost of capital utilities, with fixed 2.45% depreciation rate
JSAPYIELD: **Dividend yield on S&P 500 stock index**
 LIFEICPU: Average tax lifetime of public utilities
 PCWGDPEXP79: Expected rate of inflation for GDP deflator (with rho=.79)
 PCWICNRPU: Chained price index--public utilities
 PERICPU: Percent of depreciation taken at accelerated rate--public utilities
 PVDPNPU: Present Value of \$1 of depreciation -- Utilities
RMPUAANS: **Rate (% yield) on Aa-rated public utility bonds (based on Standard & Poors data)**
 RTCGFS: Statutory federal corporate income tax rate
 RTCGSL: Average effective state & local corporate income tax rate
 SWICPU: Switchpoint to straight-line depreciation--public utilities

For GUPI offset in SoCalGas Cost of Capital true-up:
 RMPUAANS and JSAPYIELD kept constant through 2003 at average 1997 levels.

(Equation 362 in DRI Model M US2001A)

$$\underline{COSTEQUITY} = \underline{JSAPYIELD} + 100 * (1.024 * (1 + PCWGDPEXP79 / 100) - 1)$$

(Equation 365 in DRI Model M US2001A)

$$\underline{COSTFUNDSPU} = 0.5 * \underline{COSTEQUITY} + 0.5 * \underline{RMPUAANS} * (1 - (RTCGFS + RTCGSL * (1 - RTCGFS)))$$

$$= 0.5 * (\underline{JSAPYIELD} + 100 * (1.024 * (1 + PCWGDPEXP79 / 100) - 1)) + 0.5 * \underline{RMPUAANS} * (1 - (RTCGFS + RTCGSL * (1 - RTCGFS)))$$

(Equation 681 in DRI Model M US2001A)

$$\underline{PVDPNPU} = (1 - PERICPU) * (1 / (LIFEICPU * LN(1 + .01 * \underline{COSTFUNDSPU}))) * (1 - EXP(-LIFEICPU * LN(1 + .01 * \underline{COSTFUNDSPU}))) + PERICPU * (((DBICNRPU / LIFEICPU) / ((DBICNRPU / LIFEICPU) + LN(1 + .01 * \underline{COSTFUNDSPU}))) * (1 - EXP(-(DBICNRPU / LIFEICPU) + LN(1 + .01 * \underline{COSTFUNDSPU})) * SWICPU)) + (1 / (LN(1 + .01 * \underline{COSTFUNDSPU} * (LIFEICPU - SWICPU)))) * (EXP(-(DBICNRPU / LIFEICPU) + LN(1 + .01 * \underline{COSTFUNDSPU})) * SWICPU) - EXP(-(DBICNRPU / LIFEICPU) * SWICPU) - (LN(1 + .01 * \underline{COSTFUNDSPU} * LIFEICPU))))$$

(Equation 1378 in DRI Model M US2001A)

$$icnrcostpu = pcwicnrpu / (1 + (1 - .6 * dcf) * vr) * (2.45 / 100 + Ln(1 + \underline{costfundspu} / 100) - Ln(1 + pcwgdpepx79 / 100)) * (1 - (rtcgfs + rtcgsl * (1 - rtcgfs))) * \underline{pvdnpnu} - ritcpu + dmybasis * (rtcgfs + rtcgsl * (1 - rtcgfs)) * pvdnpnu * ritcpu) / (1 - (rtcgfs + rtcgsl * (1 - rtcgfs)))$$

(DCF, VR, RITCPU, DMYBASIS all = 0.)

**Attachment E
Advice No 3199-A**

**Embedded GUPI Cost of Capital Adjustments
S&P Dividend Yield and AA Utility Bond Held Constant**

	Constant COC <u>GUPI</u>	Baseline <u>GUPI</u>	<u>Difference</u>	PBR Base <u>Margin (\$MM)</u>	GUPI offset <u>(\$MM)</u>
1997	100.0000	100.0000			
1998	102.6031	99.0325	3.5706	\$1,342	\$47.9
1999	105.8026	103.4748	2.3278	\$1,341	\$31.2
2000	109.9892	109.5956	0.3936	\$1,387	\$5.5
2001	112.4301	110.9398	1.4903	\$1,413	\$21.1
2002	115.2431	114.7872	0.4559	\$1,453	\$6.6
2003	118.6669	117.6385	1.0285	\$1,501	\$15.4

Attachment F
Advice No. 3199-A

SUMMARY OF TRANSPORTATION REVENUE CHANGES

SOUTHERN CALIFORNIA GAS COMPANY

PBR MICAM Adjustment

	BCAP REVENUES AT RATES IN EFFECT 09/01/2002 (MS) (A)	REVENUES AT PROPOSED RATES (MS) (B)	INCREASE (DECREASE) (MS) (C=B-A)	CHANGE (%) (D=C/A)
CORE PROCUREMENT:				
RESIDENTIAL	1,081,822	1,074,422	(7,399)	(0.684)
LARGE MASTER METERED	9,194	9,137	(58)	(0.629)
CORE COMMERCIAL & INDUSTRIAL	203,954	202,607	(1,347)	(0.660)
GAS A/C	157	156	(1)	(0.567)
GAS ENGINE	3,085	3,085	-	-
TOTAL CORE PROCUREMENT	1,298,212	1,289,407	(8,805)	(0.678)
CORE TRANSPORTATION:				
RESIDENTIAL	10,856	10,781	(75)	(0.688)
LARGE MASTER METERED	92	91	(1)	(0.636)
CORE COMMERCIAL & INDUSTRIAL	36,921	36,675	(246)	(0.665)
GAS A/C	20	20	(0)	(0.581)
GAS ENGINE	160	160	-	-
TOTAL CORE TRANSPORTATION	48,049	47,728	(321)	(0.668)
TOTAL CORE	1,346,260	1,337,135	(9,126)	(0.678)
NONCORE:				
COMMERCIAL & INDUSTRIAL	61,676	61,179	(498)	(0.807)
ELECTRIC GENERATION 1_/	60,816	60,468	(348)	(0.573)
NONCORE SUBTOTAL	122,492	121,646	(846)	(0.691)
WHOLESALE				
LONG BEACH	1,282	1,271	(11)	(0.858)
SAN DIEGO GAS & ELECTRIC	14,751	14,596	(155)	(1.052)
SOUTHWEST	1,338	1,327	(12)	(0.871)
VERNON	616	611	(6)	(0.939)
TOTAL WHOLESALE	17,988	17,805	(184)	(1.021)
INTERNATIONAL				
DGN	500	495	(4)	(0.890)
UNBUNDLED STORAGE	21,000	21,000	-	-
UNALLOC. COSTS TO NSBA (per J.R.)	12,012	11,765	(247)	(2.055)
NET CARE REVENUES	2,050	2,050	-	-
SYSTEM TOTAL	1,522,304	1,511,897	(10,407)	(0.684)
TOTAL ALLOCATED PPP REVENUES	124,160	124,160	-	-
UNALLOCATED PPP REVENUES	32	32	-	-
EOR REVENUES	22,777	22,777	-	-

1_/ Includes Common EG Adjustment Change of \$107M.

**Attachment F
Advice No. 3199-A**

**SOUTHERN CALIFORNIA GAS COMPANY
SUMMARY OF PRESENT AND PROPOSED RATES
PBR MICAM Adjustment**

Class of Service		Current	Proposed Rates	Increase/Decrease		
		Rates Effective 9/01/2002 (a)	Reflecting PBR MICAM Adjustment for 2003 (b)	Rate (c)=(b)-(a)	% (d)=(c)/(a)	
CORE - TRANSPORTATION COMPONENT						
Residential						
Average Residential						
	Customer Charge	\$/month	\$5.00	\$5.00	-	0.00%
	Baseline	c/th	26.842	26.550	(0.293)	-1.09%
	Non-Baseline	c/th	45.009	44.702	(0.308)	-0.68%
	Average Residential Rate	c/th	43.551	43.253	(0.298)	-0.68%
Non-Residential						
Core Commercial & Industrial						
			<u>Combined C/I</u>	<u>Combined C/I</u>		
	Customer Charge	\$/month	\$10.00/15.00	\$10.00/15.00	N/A	N/A
	Tier I (0-100 S, 250 W)	c/th	41.393	40.846	(0.547)	-1.32%
	Tier II (Tier I-4167)	c/th	24.307	24.193	(0.114)	-0.47%
	Tier III (>4167)	c/th	11.907	11.826	(0.081)	-0.68%
Gas Air Conditioning						
	Customer Charge	\$/month	\$150.00	\$150.00	-	0.00%
	Volumetric Rate	c/th	12.102	12.018	(0.084)	-0.69%
Gas Engine						
	Customer Charge	\$/month	\$50.00	\$50.00	-	0.00%
	Volumetric Rate	c/th	17.632	17.632	-	0.00%
NONCORE - Average Transmission Rate						
Retail						
	Industrial	c/th	4.234	4.200	(0.034)	-0.81%
	Electric Generation 1_	c/th	2.066	2.054	(0.012)	-0.57%
Wholesale						
	Long Beach	c/th	1.648	1.634	(0.014)	-0.86%
	SDG&E	c/th	1.020	1.010	(0.011)	-1.05%
	Vernon	c/th	1.194	1.183	(0.011)	-0.94%
	Southwest Gas	c/th	1.460	1.447	(0.013)	-0.87%
UNBUNDLED STORAGE						
Annual Reservation						
	Injection	\$/Dthd	20.169	20.169	-	0.00%
	Withdrawal	\$/Dthd	11.584	11.584	-	0.00%
	Inventory	\$/Dth	0.214	0.214	-	0.00%
Variable Charges						
	Injection	\$/Dth	0.0127	0.0127	-	0.00%
	Withdrawal	\$/Dth	0.0177	0.0177	-	0.00%
BROKERAGE FEES						
	Core	c/th	0.20100	0.20100	-	0.00%
	Noncore	c/th	0.26600	0.26600	-	0.00%

1_ / Includes Common EG Adjustment Change of 0.004 c/therm.